87-1258

Supreme Court, U.S.
FILED
JAN 26 1988
JOSEPH F. SPANIOL, JR.
CLERK

NO.

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1987

GEORGE J. PLATSIS,

Petitioner,

v.

E.F. HUTTON & COMPANY, INC.,

Respondent.

PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

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QUESTIONS PRESENTED

1. Should the common law defense of "unjustified reliance" be permitted in Rule 10b-5 claims, including fraud-on-the-market, where investors actually rely upon an underwriter-broker's practices, misrepresentations and omissions of material facts in the course of receiving investment advice?

2. Does Kennedy v Josephthal & Co., 635 F. Supp 399 (D. Mass 1985), aff'd, 815 F.2d 789 (CA1 1987) require a finding that it was unreasonable for an attorney-investor to believe that an underwriter-broker would not knowingly misinform him in the course of giving its investment advice?

3. Did the Trial Court err in finding that:

a. Known profitability projections of

reserves discovered in <u>prior</u> programs and reserves probably discoverable in <u>proposed</u> programs are <u>not material</u> and were properly withheld by Hutton as "confidential trade secrets"?

b. S.E.C. standards for reporting oil and gas reserves at prevailing and constant prices and costs reduced to present value are <u>not material</u> and may be omitted from issuers' reserve reports and offering memoranda and from Hutton's own supplemental information?

c. Between 1977 and 1984 Hutton sold economically viable drilling programs from an investor's viewpoint?

d. Petitioner's loses were due to an immediate and precipitous decline in oil and gas prices?

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PETITION FOR A WRIT OF CERTIORARI
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FOR THE SIXTH CIRCUIT

Petitioner respectfully prays that a writ of certiorari issue to review judgment and opinion of the United States Court of Appeals for the Sixth Circuit finally entered in the above-entitled proceeding on November 3, 1987.

The Court of Appeals and Trial Court opinions decided federal questions in a way which conflicts with decisions of this court, thwarts Congressional intent and threatens the effectiveness of the private action as a vital means for enforcing the securities laws of the United States.

Limiting use of the defense of unjustified reliance in 10b-5 claims, including fraud-on-the market, would (1) enhance securities laws compliance and the intent of Congress by encouraging underwriters-brokers of direct investments to

disclose known projections of profitability in terms of S.E.C. standards <u>or</u> act to protect the integrity of capital markets by restructuring non-economic programs or withholding them from market, and (2) provide recourse to "knowledgeable" investors, capable of bringing suit, who were duped by deliberately incomplete reserve reports which did not disclose oil and gas reserves in conformity with S.E.C. standards.

OPINIONS BELOW

The opinion of the Court of Appeals for the Sixth Circuit is reported at 829 F.2d 13 (1987) and is reprinted in the appendix hereto, p. 2a-5a, <u>infra</u>.

The order denying Petitioner's motion for rehearing en banc is reprinted in the appendix hereto, p. 1a, infra.

The decision of the United States District Court for the Western District of Michigan is reported at 642 F. Supp 1277, (W.D. Mich 1986) and is reprinted in the appendix hereto, p. 6a-119a, infra.

STATEMENT OF JURISDICTION

Petitioner brought suit in state court on June 23, 1983, which E.F. Hutton removed to the United States District Court for the Western District of Michigan. A non-jury trial commenced on November 26, 1985 on multiple state and federal law claims. The Honorable Chief Judge Douglas Hillman issued a decision of no cause for action on August 4, 1986 as to all claims. Opinion, Appendix page 6-119, (6a-119a).

On Petitioner's appeal, the Sixth Circuit on September 25, 1987 entered a per curiam opinion affirming in all respects the Trial Court's judgment in favor of respondent Hutton (2a-5a). On November 3, 1987, the Sixth Circuit denied rehearing and rehearing en banc (1a).

The jurisdiction of this Court to review the judgment of the Sixth Circuit is invoked under 28 U.S.C. Section 1254(1).

STATUTE AND RULE INVOLVED

This case involves Securities Exchange Commission Rule 10b-5, 17 C.F.R. Section 240-10b-5, issued pursuant to Section 10b of the Securities Act of 1934, 15 U.S.C. Section 78j, which provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) to employ any device, scheme, or artifice to defraud,
>
> (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or,
>
> (c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,
>
> in connection with the purchase or sale of any security.

STATEMENT OF THE CASE

In 1981, Petitioner sought to defer state and federal income taxes on his earned income by purchasing tax shelter investments (11a). Those are defined as investments which over time exceed what would have been earned if the taxes due in 1981 were fully paid and the remainder invested over the same time period (65a; 6th Circuit Joint Appendix (JA) 191-202, 335-357).

Petitioner sought tax shelter investment advice from the Lansing, Michigan office of E.F. Hutton and Company, Inc. ("Hutton") (9a). The Trial Court found that unquestionably, Hutton supplied investment advice to Petitioner (114a).

Petitioner specifically chose to invest in Hutton evaluated oil and gas tax shelters following investigations of oil and gas investments elsewhere (12a, 19a). His decision to invest was based upon Hutton's

expertise, integrity and stature in the tax shelter industry, especially its suitability ("due diligence") investigations of drilling program sponsors (19a, 20a, 34a-36a; Hutton's Understanding Tax Shelters, JA 149-170A-Z, 171-2).

Any investor's decision to pay taxes due on current income or to invest in drilling programs, and pay somewhat less in taxes initially, will depend upon what profitability levels can be achieved, i.e., the probable amounts of oil and gas to be found, the length of time over which they will be extracted, the net income after all expenses are paid and the present value of future net income streams generated by their sale (JA 191-202, 571-594).

Petitioner's expert Mr. Osbourne testified that drilling companies (32a; JA 140-143, 575-585) routinely make profitability determinations on wells to be drilled by adjusting downward estimates of

reserves from their theoretical potential to those quantities realized from producing wells using similar technology, in comparable geologic structures, with similar production characteristics (JA 254A-B, 304-322; Osbourne, JA 575-585, 608, 613, 637). The amounts are then multiplied by the prevailing price of oil and gas at the time of investment minus all expenses. Id. Thoughtful experts then reduce the totals to present value (Osbourne, JA 602). S.E.C. standards for reporting reserves are based on these factors, prohibiting disclosure of reserves which are not adjusted for geologic and engineering risks, i.e., only proved reserves may be disclosed (55a-62a).

Hutton represented to investors that profitability estimates were part of its monitoring of each program sponsor, which it called "due diligence" (JA 144-8, 167-180). In 1980, Hutton represented to investors in

general, and Petitioner in particular, that with respect to oil and gas investments, it was Hutton's duty to (1) assure a commonality of interest between the limited and general partners (sponsors), (2) protect investors, (3) know oil and gas reserves as well as cash flows in prior programs (4) measure the success of programs and (5) help clients evaluate drilling programs (JA 171-2). Hutton's <u>statutory</u> due diligence responsibilities under the Securities Act of 1933, pertinent to the issues raised at trial, were clearly described and widely known in the securities industry as early as 1973 (JA 139-143).

Thus, due diligence performed by experts in oil and gas is the only direct basis upon which to judge whether a substantive investment is being offered and the likely economic success of any drilling program (JA 140-3). Such due diligence evaluations also review and adjust downward

reserve values reported by issuers to investors in prior programs (Osbourne, JA 612; JA 254A-B). Then, past performance is compared with the projected profitability of the program yet to be formed (JA 254A-B).

No individual investor can afford to perform due diligence (Osbourne, JA 713) unless he has more than $500,000 at stake (JA 140).

Prospectuses of the litigated programs did not disclose profitability expectations but described the potential for each partnership to act as a tax shelter in varying terms from "tax deductions shelter income" (JA 2508) to "the tax aspects mitigate potential loss and increase the gain if production is achieved" (JA 2985).

Further, the prospectuses themselves disclosed cash flows to prior investors but did not disclose remaining reserves reported to prior program investors from which comparisons with other investments

available at the same time could readily be made (63a).[1]

Notwithstanding this, Hutton traditionally sold these investments as tax shelters since before 1970 (64a; Hutton's Understanding Tax Shelters, JA 149-170A-Z) and continued to represent them as such in 1981 through its salesmen (Joseph Potvin, JA 191-196).

The extent of any tax savings,[2] the rate of return and total income after tax in new programs can be derived from (1) actual reserve reports <u>and</u> cash flows in prior programs, an indirect method or, (2) technical engineering analyses of probable reserves from wells to be drilled in the offered programs, a direct method (20a, 63a; JA 191-196, 198-202, 304-332).

Hutton knew both of these factors but withheld the latter as confidential and freely disclosed the former, i.e., issuers' summaries of reserve values they reported to

their investors in prior programs (JA 170-180, 359-371).

In lieu of Hutton's confidential projections, Petitioner sought, and Hutton provided, reserve reports on predecessors of two of Petitioner's investments, Indian Wells and Hilliard (JA 197, 382-3). These reports indicated that prior investors would realize a total return of over three times their original investment (Indian Wells 5 to 1, Hilliard 3.32 to 1). The returns stated in these reports were comprised of both cash distributions to date <u>and</u> value of remaining reserves to be sold in the future.

It was Hutton's routine practice to circulate among its salesmen and investors alike, summaries of such reports prepared annually by sponsors of all predecessors to the programs Hutton currently offered (JA 149, 179-180, 359-371). These summaries did not comply with S.E.C. standards but used instead total net returns from oil and gas

sales in the future based on escalated prices, not discounted for time, geologic or engineering risk.

Indeed, Hutton recommended that investors review actual reserve reports from prior programs before selecting their own drilling program investments (JA 152, 171-2).

Further, before Petitioner invested in any program, Hutton's salesman, Mr. Potvin, told Petitioner that Hutton approved programs were restructured for the 1980's and would return, <u>on average</u>, three times original investment (3 to 1) in 6 to 10 years (30a) [At trial, Mr. Potvin admitted he never read any of Hutton's "due diligence", JA 1456-7]. Mr. Potvin also delivered to Petitioner a copy of an article entitled "Economic Merits and Comparisons" ("Merits") published in the Tax Shelter Digest, November 1980 which compared various returns on investment in oil and gas to tax free bond yields. For example, it indicated

that a 3 to 1 return in 10-15 years was the equivalent of a tax free bond earning 20-24% (63a; JA 198-202). Petitioner believed this article permitted an accurate comparison of reserve values to bond equivalent yields (20a). The Trial Court agreed (63-66a).

Petitioner knew that the sections in each prospectus entitled "proposed and prior activities" (18a, 20a, 30a, 40a), omitted information to judge the quality (or bona fides) of the offering (16a, 40a), after tax rates of return to prior investors, reserves discovered in prior program and profitability projections, before or after tax, for leases to be drilled (65a).

Nevertheless, based on the advice and representations of Mr. Potvin, the "Merits" article and reserve and return data Hutton supplied, Petitioner invested a total of $276,000 (including assessments) in 11 different programs evaluated by E.F. Hutton (14a). Hutton never dissuaded Petitioner

from these investments it long recommended (JA 152). Indeed, Mr. Potvin recommended in writing that Petitioner purchase them for tax shelter purposes because they would preserve his assets (30a; JA 191-195). Petitioner did not seek investment advice from any other person or brokerage firm in making his decision to invest (24a).

Of the 500 wells drilled, one-half or 250 resulted in production, which were equally divided between "low risk-low reward developmental wells and high risk-high reward exploratory wells" (26a).

About 50% of a well's total production is extracted within the first 4 or 5 years of its existence (Osbourne, JA 583-585). Reserve estimates are most accurate after production stabilizes in the first or second year (Osbourne, JA 582).

Between 1980 and 1986, the litigated programs sold oil for an average price of $31 per barrel ($35 in 1981, $32 in

1982, $30 in 1983 and 1984 and $26 throughout 1985) and gas for an average price of $3.15 per thousand cubic feet (MCF, minimum prices were $3.15 in 1982, $3.35 in 1982, $3.75 in 1983, $3.95 in 1984 and $4.11 throughout 1985) (JA 401-402). The ratio of oil to gas produced from Petitioner's programs was about one to one.

By December 1982, most of the drilling had been completed in Petitioner's eleven programs. All but one program had published two consecutive annual reserve reports apiece, in December 1981 and December 1982. In April, 1983, Hutton's corporate officers in New York City told Petitioner that based on these reported reserves, total return from all of his investments would be 1.6 to 1, "proved" reserves only (JA 400). According to the "Merits" article, such a return would be the equivalent of a tax free bond yielding 5% (63a; JA 198-202).

Dissatisfied with Hutton's excuses for a total after tax return of only 5%, Petitioner filed suit in June 1983.

By the close of trial in February 1986, when oil was selling for $26 a barrel and gas for about $4.00 per MCF, Petitoner's potential total return was less than 0.4 to 1. The total value of the $276,000 investment as of December 31, 1985 was less than $100,000; $77,270 in cash distributions and $23,000 in reserves still in the ground. This represents a negative return after tax (27a, JA 202) and a positive loss of after tax investment capital.

This return is the equivalent of an investor paying all taxes due on earned income of $276,000 ($138,000 in the 50% bracket) and losing 80% of the $138,000 remaining after tax. Put another way, $138,000 of the after tax dollars invested in tax free bonds in 1981, paying 10% per year,

would have a total value of $276,000 by the end of 1987, tax free (Rule of 72).

Of the total 450 million dollars invested in the litigated programs nationwide, investors lost 180 million dollars after tax, while the United States Treasury lost 225 million dollars of income tax revenue.

During pretrial discovery in 1985, Hutton produced its confidential "due diligence" reports on the litigated programs and their predecessors, which included profitability projections. Based upon prevailing prices held constant, they revealed that oil and gas investors (limited partners) in programs as far back as 1964 would earn an average (and median) of only 1.33 to 1. Programs proposed for sale in 1978 through 1983 projected similar returns (1.35 to 1). The average projected return to limited partners was always less than 2 to 1 (JA 254A-B).

Those same reports also estimated that the general partners, who were paid for drilling the wells and who also received half of the profits from productive wells, would earn four times their investment (4 to 1) in the same programs (JA 254A-B). Again, this was both the median and average return. They would receive similar returns even after 1978 when Congress amended the Internal Revenue Code.

Mr. Osbourne testified that projected returns to the limited partners were non-economic, i.e., they would lose nearly all their investment in every program (JA 593-621, 673). He testified that an investor would have to receive a return in <u>cash</u> of 2.29 times his original investment before the end of 10 years to equal the return of tax free bonds (bond principal plus all interest payments) available to investors in 1981 (JA 202, 630-4) which were paying 10% (JA 398-399).

He also testified that to obtain a competitive and adequate return commensurate with the risks in oil and gas, an investor should receive cash of at least 4 times his investment (4 to 1) within 10 years (33a), the same as the general partners (JA 202, 254A-B).

After eight days of trial, the Trial Court issued its opinion of no cause for action under any state or federal law (6a-119a).

The Trial Court found that Petitioner had no one to blame but himself (42a, 48a); he knew there was no factual basis in the offering materials to suggest wells would, in fact, ever by drilled; or that they would be drilled where experts reasonably expected to find oil and gas (42a).

Though Hutton had access to insider information (35a) and routinely supplemented the contents of the prospectus here

litigated, the Trial Court did not find that Hutton acted with scienter, that profitability projections or reserves known to Hutton through its "due diligence" were material or that Petitioner relied upon Hutton's practices to his detriment. The Trial Court did not find that reserve reports supplied by Hutton, or summaries thereof, were misleading in the circumstances.

Mr. Osbourne testified that Hutton knew that all of these programs would lose limited partner's investment capital (JA 627, 628, 649, 671).

In denying relief under Rule 10b-5, the Trial Court relied upon Kennedy v. Josephthal & Co Inc, 635 F Supp 399 (D. Mass 1985), affirmed, 814 F.2d 798 (1st Cir 1987), which held that plaintiff investors did not justifiably rely upon the broker's statements where they were sophisticated investors who read the prospectus disclosing every material fact.

The Trial Court found Petitioner was unreasonable in believing and placing reliance upon Hutton's "due diligence", disclosure of reserves or its practice of representing these as good tax shelter investments (13a, 45a, 65a, 74a). The Trial Court said nothing about the ambiance in which these investments were sold (JA 149), the poor quality of reserve data Hutton (and issuers) supplied to investors before and throughout the investment period or Mr. Potvin's (and Hutton's) recommendation to purchase these investments as suitable for Petitioner's objectives (JA 191-196). Nor did the Trial Court impute to Hutton the knowledge summarized in the 1980 "Merits" article (JA 198-201), the 1973 article describing an underwriter's due diligence obligations (JA 139-143) or the results of Hutton's own "due diligence" (254A-B).

REASONS FOR GRANTING THE WRIT

IT IS REVERSIBLE ERROR TO REQUIRE PROOF OF "JUSTIFIED RELIANCE" UNDER PETITIONER'S 10b-5 CLAIMS, INCLUDING FRAUD-ON-THE-MARKET, WHERE THE UNDERWRITER-BROKER OMITTED KNOWN PROJECTIONS OF PROFITABILITY WHICH DEMONSTRATED THAT THE INVESTMENTS WERE ECONOMICALLY UNSOUND AND UNSUITABLE FOR ANY INVESTOR'S OBJECTIVES.

The courts below have decided federal questions in a way which substantially conflicts with Affiliated Ute Citizens v. United States, 406 U.S. 128, 153, 154 (1972), Ernst & Ernst v. Hochfelder, 425 U.S. 185, (1976), and Bateman Eichler, Hill Richards, Inc., v. Berner, 472 U.S. 299 (1985). Further, their decisions threaten private enforcement of the securities laws and thwart Congressional intent toward these investments. Neither reliance nor justified reliance needs to be proven by plaintiffs.

RELIANCE

The elements of a claim under Rule 10b-5 (a) and (c) involving primarily

nondisclosures are set forth in Affiliated Ute. Specific or justified reliance and proximate causation are not elements required to be established by plaintiffs. Establishing a duty to disclose and materiality of the omitted data alone are sufficient for recovery. Reliance and causation of damages are presumed through a finding of a duty to disclose and materiality.

Here, profitability projections known to Hutton were omitted from the issuers' prospectuses, Hutton's supplements thereto and Hutton's own written and oral statements about these investments. Projections were so low, in fact, that no investor would purchase them for any purpose if he knew those estimates. Risk of loss was absolute in every program. The omitted due diligence data was totally inconsistent with any purpose for which these investments might be purchased, investment or tax shelter. In

short, establishing that the primary underwriter had a duty to investigate the issuers and effectively disclose its findings to investors, Escott v. Barchris Const Corp., 283 F. Supp 634 (S.D. N.Y. 1968), and the materiality of the omitted projections, TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438 (1976), should be sufficient to establish reliance and damage causation where there is this impossibility of performance. The Trial Court was simply wrong in requiring Petitioner to establish "justified reliance" in the circumstances.

Moreover, academicians suggest that the Affiliated Ute rule should also apply in Rule 10b-5 (a), (b) and (c) claims involving mixed questions of omissions and misrepresentations. Causation And Reliance In Private Actions Under SEC Rule 10b-5. Michael P. Whalen in cooperation with Professor Louis Loss. Pacific Law Journal 13: 1003, 1064 (1982).

Here, profitability projections were either not disclosed in the prospectuses or were misleading when disclosed by Hutton's oral and written supplements thereto (59a, JA 197, 382-3). Reserve values were never presented in accordance with S.E.C. standards, or even those utilized by Hutton's own geologist in preparing his estimates (JA 315). Further, Hutton misrepresented these "investments" as tax shelters (65a), while omitting profitability projections and after tax returns which clearly demonstrated they were not.

Non-reliance clauses (21a) stating that investors relied only on the written contents of prospectuses in making their investments are designed to protect issuers, and should not shield Hutton from its own wrongful acts and omissions in marketing these investments.

Rule 10b-5 is concerned with more than the meaning of words. It is concerned

with business practices which operate as frauds. S.E.C. v. Capital Gains Bureau, Inc., 375 U.S. 180, 186-187 (1963). To require more than proof of a duty to disclose and materiality thwarts Congressional intent and threatens private enforcement of the securities laws. Unclean Hands And Self-Inflicted Wounds: The Significance Of Plaintiff Conduct In Actions For Misrepresentation Under Rule 10b-5. Theresa A. Gabaldon, Minnesota Law Review 71:317 (1986).

Hutton's practices which injure capital markets should be a more pressing concern than investors who may have misunderstood vague descriptions of risks (31a) and indecipherable data (Osbourne, JA 721) or who used flawed logic thinking these investments avoid taxes (Osbourne, JA 635). After all, investors lost nearly all of their investment capital.

In Berner, this Court held that common law defenses are inappropriate to the enforcement scheme of the federal securities laws.

Consistent with the holding in Berner, the Trial Court should have asked (1) whether it was more important to enforce Hutton's professional responsibilities than deter investors' reliance upon underwriters-brokers, (2) who was more culpable in the circumstances and (3) whether the public interest in efficient markets for direct investments outweighs considerations of equity between the parties. Gabaldon, supra, p. 358.

The Josephthal case relied upon by the lower courts is clearly distinguishable. There, plaintiffs were allowed to deduct from taxable income nearly 10 times their investment (1000%). Id. 814 F.2d at 800. In essence, they tripled their money "tax free" through deductions alone.[3]

Here, Petitioner could deduct no more than 83% of his investment under the Internal Revenue Code as amended in 1978. Deductions in oil and gas after that were limited by Congress to no more than the amount of total investment "at risk" minus front-end load such as commissions. Petitioner will be lucky if he receives back 40% of his original investment (.2 to 1 after paying taxes).[4]

In Josephthal, only one program was involved. Here, 11 different programs, in as many states, are involved.

The Josephthal plaintiffs were on notice from reading the prospectus alone that in all likelihood the issuer's project would utterly fail as a viable coal mining operation. The prospectus clearly stated that operations would be unprofitable at the prevailing price of coal even if operations fully developed the field.

Here, Hutton and the litigated prospectuses did not disclose profitability based on prevailing prices for oil and gas. Instead, Hutton supplied investors with issuers' estimates based on escalated prices for oil and gas (JA 361-7, 382-395), which were not in conformity with S.E.C. standards (56a-62a).[5] Hutton did not follow through on its publically announced commitment to all investors in 1980 to: (1) assure a commonality of interest between the limited and general partners, (2) protect investors, (3) measure the success of oil and gas programs and (4) help clients evaluate drilling programs (17a-18a; JA 171-2).

In short, Hutton failed to disclose what its own "due diligence" revealed, i.e., the litigated programs would be unprofitable from any investor's viewpoint at prevailing prices for oil and gas even if operations fully develop available leases (all wells drilled program-wide actually produce as

estimated), especially when after-tax returns are carefully accounted for. They could not perform as tax shelters because projected pre-tax returns were too low (Osbourne, JA 593-621). In real terms, any fixed income security purchased with equivalent after tax dollars at any time after 1978 <u>always</u> earned more than Hutton approved drilling programs (65a; Osbourne, JA 604, 610-618, JA 198-202, 254A-B).

Further, the <u>Josephal</u> prospectus said similar ventures had been unprofitable for years. p. 801.

Here, Hutton represented that sponsors it monitored since the 1970's had programs which were successful tax shelter investments for years prior to Petitioner's purchases of their current offerings (JA 152).

The Securities Act of 1933, modeled after the English Companies Act, is designed "to protect the investing public by

compelling detailed disclosure of facts sufficient to put the buyer in the same league with the seller." In re GAP Stores Securities Litigation, 79 F.R.D. 283 (1978) This, the litigated prospectuses did not do Nor were the terms of the deal - the allocation of risk and reward - equitable. Petitioner was not on an equal footing with the issuers or Hutton. An issuer's duty to disclose in the first instance, should beco greater in scope when its underwriter promotes and sells their offerings as "tax shelters."

Unlike the plaintiffs in Josephthal, 8 F.2d at 804-5: (1) Petitioner was not sophisticated in tax shelter or oil and gas investments in 1980. In the beginning, Petitioner was a neophyte (8a). He had no existing, long standing business or persona relationship with Hutton or any brokerage house (8a); (2) Petitioner believed that Hutton understood tax shelter investments because of its "insider" knowledge and its

experience and stature as an underwriter of oil and gas programs (19a, 34a-36a, 64a-66a). Further, Hutton's "insider" information (34a-36a); indicated that prosectuses were incomplete. (3) Investors did not initiate their interest in Hutton screened programs. Hutton sought them out by advertising its expertise and touting oil and gas investments as tax shelters (JA 144-183). (4) Investors could not have known that profitability projections in <u>all</u> Hutton approved programs <u>remained constant</u> or declined from 1964 through 1983 despite the imposition of the "at-risk" rule in 1978, reducing deductions (and therefore tax savings) by 80%, from 168% to 80% of total investment, and rising interest rates since 1978 (JA 254A-B, 397-9, 655). Even the Trial Court found evidence that the litigated programs were losers from the start (77a). Osbourne so testified (JA 606, 609-620). The litigated programs, which Hutton approved, did not project an increase

in pre-tax returns after 1978 sufficient to maintain the same after tax returns their predecessors generated before 1978, or to keep abreast of ever rising bond yields; (5) Without access to Hutton's projections, investors could not have detected this total impossibility of performance; (6) Specific statements did not "fairly leap" from the memoranda to contradict Hutton's implied and expressed representations. Hutton supplied reserve values could not conflict with prospectuses, which omitted such data.

Here, Petitioner intentionally selected tax shelter programs evaluated and approved by Hutton.[6] Once told its "due diligence" was confidential, he did the next best thing. Petitioner examined issuer prepared reserve data supplied by Hutton. Hutton represented to investors that such data was material (JA 152, 171-2), but was omitted from prospectuses because of a

Securities and Exchange Commission Ruling (30a).

Ultimately, he was influenced to invest by the availability of drilling programs through a national brokerage firm which performed, as the Trial Court found, "state of the art due diligence" (36a). Petitioner's reliance was certainly well placed (66a-67a), if not justified.

In short, Hutton should be liable to investors who purchased these programs without knowing profitability projections Hutton knew through its own "due diligence".

> [Defendant] disclosed acts of his that spoke louder than any oral expression could to the effect that in his judgment, the coal mining leases were a sound investment....[Defendant] was surely not so naive as to be unaware of the basis for the high value placed upon his references.
> Sirianni v. S.E.C., 677 F.2d 1284, 1287 (9th Cir. 1982).

FRAUD-ON-THE-MARKET

The Trial Court's finding (78a-80a) that recovery on a fraud-on-the-market theory under Shores v. Sklar, 647 F.2d 462 (5th Cir. 1981) is not available in face-to-face transactions (80a), conflicts directly with the holding in Affiliated Ute (p. 153).

Recovery on a fraud-on-the-market theory should be available in cases like this one. In Shores, the plaintiff-investor instructed his broker to purchase a new bond issue. He did not read the prospectus. The Court held that "reliance" upon the written prospectus was not a requisite element of plaintiff's proofs because the bonds were not entitled to be marketed in the first place.

Here, new issue investments in drilling partnerships yet to be formed, are analogous to the new bonds sold in Shores, i.e., the litigated programs, as structured, would not have sold after 1978, but for the

misrepresentations and omissions of the issuers and Hutton in marketing them. What was missing were reserve data stated in terms of the S.E.C. standard and profitability projections contained in Hutton's "due diligence".

Investors' carefulness, knowledge or lack thereof in purchasing these investments had nothing to do with their losses. The programs were bound to lose limited partners' investment capital because of their structure and general lack of economic fundamentals. Losses were dependent upon Hutton's misconduct in not analyzing these investments "after tax" during its underwriting process and in tolerating the use of inflated reserve values.

Hutton helped to establish an aura about these investments unjustified by their real performance (JA 254A-B). Ultimately, "sophisticated" and ordinary investors alike were victimized. Regardless of the issuer,

accounting safeguards, or whether a high risk-high reward exploratory program or low risk-low reward development program was involved, invariably these programs were incapable of serving as tax shelters.

Indeed, even Hutton's own broker, Mr. Potvin, was victimized (70a) into believing these were effective tax shelters (JA 191-202), and could legitimately be sold as such. Like other investors, he believed that reserve values issuers reported to prio investors could be relied upon to derive equivalent tax free bond yields ("Merits" article, JA 198-201). Though the "Merits" article was accurate (63a), reported reserve circulated by Hutton and issuers alike were not.

The success of Hutton's massive selling effort was more dependent upon investors' perceptions created and manipulated by the issuers and Hutton alike.

> [Prospectuses were] only one step in the course of an elaborate scheme...to create [an issue] that would appear genuine but was so lacking in basic requirements that...had any one of the participants in the scheme not acted with intent to defraud or in reckless disregard of whether the other defendants were perpetrating a fraud [the issue would never have been marketed].
>
> Shores, 647 F.2d at 468.

It was not unreasonable for investors to believe that these investments were capable of operating as tax shelter investments ("Merits" article, JA 198-201) merely because of their presence in the market place through a national underwriter. It was reasonable for them to believe they were made available and recommended because data known to Hutton suggested they would operate as tax shelters.

> Extensive federal regulation of securities persuade investors to expect some minimal degree of protection against totally unmarketable securities, and when fraud is especially egregious, protection is so important that individual reliance should not be required for recovery. Second, the underwriting process arguably performs the same valuation function for new issues that the impersonal trading

> market performs for traded issues. Whe
> underwriters join the fraudulent scheme,
> there has been no honest valuation.
> Fraud on the Market, Harvard Law Review,
> 95, 1143, 1157.

In short, issuers should be oblige to disclose reserves discovered in their prior programs using S.E.C. standards. <u>In r</u> <u>GAP</u>. Hutton, as lead underwriter and broker should be obliged to do the same, as well as look at these investments from the investors point of view and accurately disclose its findings to them. Otherwise, Hutton was dut bound to reject these programs as unmarketable when they serve no valid purpos to the limited partners (18a; JA 139-143). Hutton admitted as much (JA 171-172). This obligation should intensify when Hutton give investment advice to its clients.

<u>Affiliated Ute</u> held that defendant who dealt directly with plaintiffs, in a distinct sense, were the market makers. In real sense, Hutton was (and is) the market maker for oil and gas programs. Without

Hutton's sales effort, programs projecting returns of 1.35 to 1 on average would not have sold at any price in 1981 or at any time since (80a, Osbourne, JA 702-3, 722, 786; JA 202). Without the issuers' exaggerated reserve reports or Hutton's unverified claims they were tax shelter investments, neither Hutton nor the issuers would have sold these programs.

Petitioner fully expected a few programs might be non-economic in real terms. Nothing was disclosed to suggest that all of the litigated programs would be so. Simply put, these programs were not entitled to be marketed in 1981. Shores, 647 F.2d at 469.

Failing to apply the law announced in Shores, Berner and Affiliated Ute, Hutton will continue to sell otherwise unmarketable securities with impunity. Hutton will knowingly circulate to investors misleading reserve data supplied by issuers while withholding its own realistic profitability

projections. It will do this so long as the S.E.C. exempts drilling programs from its reserve reporting standards. There will be no legal requirement that Hutton (or issuers place investors on an equal footing with the issuers, i.e., disclose projections that investors will earn on average only 16-64 cents for every dollar invested.[7] Similarly nothing will cause Hutton to discontinue marketing so-called tax shelter investments earning less than tax free bonds (JA 202) or to so advise its clients.

> [The] primary objective of the federal securities laws - protection of the investing public and the national economy through the promotion of 'a high standard of business ethics...in every facet of the securities industry' is achieved in part by denying common law defenses. Berner, p. 315.

On the one hand, Petitioner was careful. He participated in capital generating markets through a national broker-underwriter holding itself out as especially skilled in tax shelter investments. He read the prospectuses and

conducted reasonable investigations. He exercised thoughtful judgment and followed Hutton's recommendation to diversify (in 500 wells). Neither Petitioner nor any other investor could have learned what Hutton knew after 1978, i.e., drilling programs <u>always</u> earn less than bonds (JA 202).

> [No investor has] the geological know-how, technical background and business acumen to enable him to evaluate the risks incident to a proposed drilling venture.
> Use of Limited Partnerships To Finance Drilling Ventures - Enter Rule 146. Oil and Gas Tax Quarterly, Vol. 23, Sept. 1974, page 1, 10-12.

On the other hand, Hutton never fully performed its underwriting function as required by law. It failed to analyze these investments from the investor's viewpoint, i.e., <u>after-tax</u> (JA 139-143, 191-195). It merely assumed traditional before tax returns were adequate, even after the 1978 amendments to the Internal Revenue Code (66a; JA 154A-B). Further, Hutton violated its duty, in the circumstances of this case, to

disclose _all_ material facts, i.e., reserves stated under S.E.C. standards and projections of qualified experts employed by Hutton.

> Selective disclosures [commit a potentially broader range of violations...and are] particularly egregious when committed by a securities professional, who owes a duty of honesty and fair dealing toward his clients. _Berner_, p. 313-4.

The omitted "due diligence" projections of discovered _and_ discoverable reserves, which permitted accurate comparisons of oil and gas with other investments, would have significantly altered the total mix of information available to investors. _TSC Industries, Inc_. Instead, Hutton misrepresented profitability by substituting issuers' inflated reserve values, distributed directly to its salesmen and customers, for lower values based on S.E.C. standards used by experts (JA 179-80, 359-371, 386), _and_ by its own independent geologists.

Omitting projections of qualified experts is actionable where their opinions are reliable. <u>Eisenberg</u> v. <u>Gagnon</u>, 766 F.2d 770, 775 (3rd Cir. 1985). Profitability projections like those found in Hutton's "due diligence" reports have been used in the industry for years (Osbourne, JA 579-581). Oil and gas reserve data and projections based on S.E.C. standards are reliable. <u>Starkman</u> v. <u>Marathon Oil Co</u>., 772 F.2d 231 (6th Cir. 1985).

Here, Hutton knew reserves were omitted from prospectuses (30a, 58a) but that they were important to investors in selecting investments (JA 152, 171-2).

Hutton also knew investors had no basis upon which to judge the soundness of these investments other than by reliance upon (1) discovered reserves in prior programs or the "track record" of the sponsors, (2) discoverable reserves in proposed programs (profit projections of the program to be) <u>or</u>

(3) the reputation and experience of the underwriter-broker who recommends their purchase (JA 139-143, 198-202).

Hutton sold these programs because they were saleable, by hyperbole, not because they made any economic sense for the limited partners, before or after tax.

In the circumstances, Hutton should not be relieved of its responsibilities. Barchris; Herman & MacLean v. Huddleston, 45 U.S. 375, 382 (1982), Berner.

> Positive proof of reliance is not a requisite to recovery. All that is necessary is that the facts withheld be material ... This obligation to disclos and this withholding of a material fact established the requisite element of causation in fact.
> Affiliated Ute, p. 153-4.

In short, the Trial Court should have afforded relief under Rule 10b-5.

CONCLUSION

This court has held that where broadly social issues are at stake, a carefu

review of the record is in order. Bose Corporation v. Consumers Union of the U.S., Inc., 466 U.S. 485, 500, 501 (1984). The questions here presented involve the integrity of capital markets crucial to this country's welfare. "In some areas of the law, the stakes - in terms of impact on future cases and future conduct - are too great to entrust them finally to the judgment of the trier of fact". Id. This should be especially true where the Trial Court had great difficulty understanding Petitioner's claims (29a).

In 1981 alone, the litigated programs raised 450 million dollars throughout the United States (JA 1556, 1729, 1839, 2103, 2233, 2353, 2452, 2644, 2821, 2918). By 1980, Hutton sold more than one billion dollars in tax shelter investments (JA 149), 300 million dollars in 1979 alone (64a).

Oil and gas development is essential to the economic welfare of the United States and its national security. It will continue to require enormous amounts of investment capital (64a). To assure a willingness of the public to make such investments, accurate and complete knowledge, given the state of the art for estimating the value of oil and gas compared to alternative investments, must be conveyed to investors (JA 139-143, 202). Shifts in capital, should not occur without it.

Underwriter-brokers like Hutton were, and continue to be, in the best position to assure that such knowledge reaches investors. At the very least, an underwriter like Hutton can assure that such knowledge "efficiently" impacts an investment's capacity to attract capital. An investment's popularity should reflect its basic economics, not its hyperbole.

While each prospectus described these as high risk investments, nothing was presented to allow investors to evaluate their risk or assess their after tax consequences, the objective for which they were offered by Hutton. Hutton supplemented prospectuses with the most persuasive information, while withholding the most informative data. No investor wants to lose his investment capital. Yet Hutton encouraged investors to buy worthless tax shelters <u>after</u> 1978 when Congress amended the Internal Revenue Code.

In 1978, Congress sought to halt these practices by adopting the "at risk rule". Congress intended to eliminate certain tax incentives in order to force oil and gas investments to pay for themselves. Yet, profitability projections for the litigated programs between 1964 and 1983 did not increase with the rise in interest rates in order to compensate for a substantial loss

of tax deductions after 1978 (JA 254A-B). Obviously, the intent of Congress was to cut tax subsidies to the oil and gas industry and divert capital to more efficient enterprises, if not the national treasury.

Drilling wells which have no chance of returning a fair profit on investment, under current technology and prices, and partnerships otherwise non-economic due to program structure allocating risk and reward, are not in the best interest of this nation. Like conspicuous consumption, they misallocate scarce capital and deprive the country of essential tax revenues (Osbourne, JA 635).

Underwriter-brokers should be discouraged from repeating the practices exemplified by Hutton's conduct in this case which can only damage investor confidence and thwart the intent of Congress.

For the foregoing reasons, a writ of certiorari should be granted to review the

judgment of the United State Court of Appeals for the Sixth Circuit.

Respectfully submitted,

George Platsis

George J. Platsis, Pro Se
2019 Shagbark
Okemos, MI 48864
(517) 349-5770

Dated: January 27, 1988

FOOTNOTES

[1] Apache's prospectus disclosed both cash distributions and reserves discovered in prior programs, though the reserves were not stated in standard S.E.C. terms, i.e., Apache escalated prices for oil and gas and did not confine disclosures to proved reserves discounted at 10% (JA 250). It also reported "possible" and "probable" reserves, which were not adjusted for risk. Once such reserves are adjusted for engineering and geologic risks, the remaining value approaches what may be considered the equivalent of "proved undeveloped" reserves (60a-61a).

[2] Prior to 1978, an average of 168% of the amount of the investment could be deducted from taxable income received from any source. Since 1978, less than 85% of any investment can be so deducted. (JA 250) Therefore, post-1978 programs are at best only tax deferral investments. Only if returns actually exceed available tax free bond yields will an investor receive any "real tax savings" (JA 191-202, 2386; Figures & tables attached to Petitioner's briefs in the Sixth Circuit Court of Appeals; Osbourne, JA 635, 710). Otherwise, an investor is better off

to pay his taxes and invest the remainder in bonds.

[3] Id.

[4] Id.

[5] See Note 1; The S.E.C. requires all pricing to be at prevailing prices and costs, with all resulting future net revenue from "proved" reserves reduced to present value at the rate of 10% per year.

[6] Hutton had the burden of proof to establish that it carried out its due diligence obligations imposed by Section 11 and/or 12 of the Securities Act of 1933. That includes thoroughly understanding these investments and paying attention to every detail (JA 139-143). Wilko v. Swan, 346 U.S. 427 (1953). Comparison with bond investments can be the only yardstick according to experts (63a-65a; JA 198-202). This, Hutton should have done (JA 139-143). Escott v. Barchris Const Corp, 283 F. Supp 634 (S.D.N.Y. 1968).

[7] Once average program-wide dry hole experience is accounted for, i.e., 80% of all wells drilled by Indian Wells and Woods were

completed as producers while less than 20% o
the wells drilled by Can Am, Sanchez-O'brien
and Forest were producers the average return
of 1.35 is reduced to 1.08 and .27
respectively. If these returns are further
reduced (by 40%) to reflect payment of taxes,
"due diligence" projections of 1.35 to 1
become respectively .64 and .16 cents
returned after tax for every dollar invested
In this case, 50% of all wells combined
resulted in production. Therefore,
Petitioner could expect a total return of 47
cents over the life of the programs combined
for every dollar he invested. Note that if
he had merely paid taxes due in 1981 of abou
50% he would have had 50 cents left over fro
every dollar he could have invested in
drilling programs. That 50 cents would have
earned interest at a rate of 10% or more per
year since then. In 10 years, he would have
had one dollar returned after tax for every
dollar he could have invested in drilling
programs. It was known in 1973 that to be
competitive with other investments, <u>after ta
returns should exceed 1.25</u>. The acceptable
range at that time was 1.25 to 3.5 after tax
for every dollar invested (65a). Clearly,
Hutton's "due diligence" did not select
programs in 1981 whose after tax returns

would be near, let alone equivalent, to those acceptable before 1978.

NOTE: Principal references made herein to the Joint Appendix (JA) are found in Volumes I and II, pages 1-802, of the Joint Appendix in this matter filed with the Sixth Circuit Court of Appeals on February 13, 1987.

No. 86-1781
UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

GEORGE J. PLATSIS, CORRECTED
Plaintiff-Appellant,

v

E.F. HUTTON & COMPANY INC.,
Defendant-Appellee

BEFORE: JONES, WELLFORD and GUY, Circuit Judges

The Court having received a petiton for rehearing en banc, and the petition having been circulated not only to the original panel members but also to all other active judges of this Court, and no judge of this Court having requested a vote on the suggestion for rehearing en banc, the petition for rehearing has been referred to the original hearing panel.

The panel has further reviewed the petition for rehearing and concludes that the issues raised in the petition were fully considered upon the original submission and decision of the case. Accordingly, the petition is denied.

Filed: November 3, 1987

ENTERED BY ORDER
OF THE COURT

John P. Hehman,
Clerk

No. 86-1781

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

GEORGE J. PLATSIS,
Plaintiff-Apellant,

CORRECTI

v.

E.F. HUTTON & COMPANY, INC.,
DISTRICT OF MICHIGAN.
Defendant-Appellee.

Decided and Filed September 25, 1987

BEFORE: JONES, WELLFORD and GUY, Circuit Judges.

PER CURIAM. After investing substantial sums in a number of oil and gas tax shelters following consultation with an official and sales representative of defendant E.F. Hutton & Company, Inc. ("Hutton") in Lansing, Michigan, plaintiff, George Platsis, an attorney, has sued Hutton for damages because of losses eventually incurred. The relationship between the parties commenced in

1980 shortly before a sharp decline in oil and gas prices. All but one of Platsis' investments were in publicly offered oil and gas limited partnership based on prior issuance to him of a prospectus and other investment material before the decision to make an investment. All investments were made with an admitted prime purpose of tax savings. One final investment came about through direct communication between plaintiff and the program sponsor; Hutton did not act as sales agent.

Platsis suffered the loss of the major part of his investment. He claims that Hutton and its representative, Joseph Potvin, made oral misrepresentations about the nature and character of these investments and that he relied upon them to his detriment. He also claims violations of sections 11(a), 12(1) and 12(2) of the Securities Act of 1933, written misrepresentations, violations of section 10 and Rule 10b-5 of the

Securities Exchange Act of 1934, and violations of the Michigan Securities Act. In addition, Platsis claims that Hutton and its agent were guilty of fraud and a violation of the Michigan Consumer Protection Act as well as a breach of fiduciary duty which it owed to him as a customer and investor. Finally, plaintiff claims a breach of contract and violations of the Racketeer Influenced and Corrupt Organization Act (RICO), 18 U.S.C. sections 1961-1968.

Judge Douglas Hillman considered the proof and evidence and rendered an extensive opinion finding for defendant Hutton and against each of plaintiff's contentions. See Platsis v. E.F. Hutton & Co., Inc., 642 F. Supp. 1277 (W.D. Mich. 1986). The district court opinion addresses each of plaintiff's claims and makes findings as to each from which he concluded that plaintiff has failed to carry his burden of proof. He cited in support of his legal conclusions a number of

authorities, including a then district court decision, Kennedy v. Josephthal & Co., Inc., 635 F. Supp. 399 (D.Mass 1985). That decision has since been affirmed by the First Circuit Court of Appeals at 814 F.2d 798 (1st Cir. 1987).

For the reasons carefully set out by Judge Hillman and based upon the additional authority of Josephthal, heretofore referred to, we AFFIRM the judgment for the defendant, Hutton, in all respects.

George James PLATSIS, Plaintiff,

v.

E.F. HUTTON & COMPANY
INC., Defendant.

No. G83-784 CA(5).

United State District Court,
W.D. Michigan, S.D.

Aug. 4, 1986.

Securities investor brought action against brokerage house under Securities Act of 1933, Securities Exchange Act of 1934, Michigan Consumer Protection Act, Michigan Uniform Securities Act, Racketeer Influenced and Corrupt Organization Act as well as for breach of contract and breach of fiduciary duty. The District Court, Hillman, Chief Judge, held that security investor failed to establish that alleged oral or written misrepresentations made by brokerage house induced securities investor to invest in oil and gas limited partnerships resulting in loss of securities investor's investment.

Judgment for defendant.

George J. Platsis, Okemos, Mich., pro se.

Warner, Norcross & Judd by William K. Holmes, Grand Rapids, Mich., Kutak Rock & Campbell by Lindsey Miller-Lerman, Omaha, Neb., for defendant.

OPINION

Hillman, Chief Judge.

BACKGROUND

The plaintiff in this action, George Platsis, age 47, is an educated and intelligent man, having graduated from the University of Michigan Law School. Prior to entering law school, he completed three years of medical school, finishing in the top third of his class. Plaintiff taught physiology to medical students prior to entering law school.

Upon graduation from law school, he was employed at the Federal Trade Commission where, for approximately a year and a half he participated in trial preparation and document production.

Upon leaving the Federal Trade Commission in October, 1969, plaintiff was trial attorney for the Michigan Department of Attorney General, Consumer Protection Division; from January, 1971, until May, 1975, he was a trial attorney for the Department of Transportation, specializing in

condemnation and highway negligence defense work.

Plaintiff began solo practice in Michigan in 1975, as a trial attorney specializing in plaintiffs' personal injury, medical malpractice and highway negligence defense and condemnation as a Special Assistant Attorney General. Plaintiff is married to a science and mathematics teacher and has two teenage daughters. He and his family live in Okemos, Michigan.

Prior to 1981, plaintiff had only a small amount of investment experience. He testified to having taken a course in securities law at the Michigan Law School. His investment experience was limited to purchase of mutual funds and apparently a small number of shares in Ford Motor Company securities.

Defendant Hutton is a major brokerage house, licensed by the Securities and

Exchange Commission and acts as a sales agent or broker to investors.

Plaintiff's relationship with Hutton commenced in late 1980, when he anticipated the receipt in 1981, of a substantial contingent fee in the amount of approximately $500,000. Although the record is not totally clear concerning this earned income from his law practice, aside from the contingent fee, plaintiff testified that his income before 1981, averaged "about $50,000".

Upon receipt of the lump sum contingent fee, plaintiff sought tax shelter investment advice from Hutton's Lansing, Michigan office. Specifically, plaintiff was interested in investments that would help reduce his tax burden. Plaintiff testified that he thought it was "unfair" that he should be taxed at a high income rate in one year for income received from work performed over a period of at least six years on one case.

Plaintiff established several accounts with Hutton over the course of time, the initial one consisting of a $500,000 deposit on October 23, 1980. On January 30, 1981, plaintiff transferred almost this entire sum to his personal Hutton account.

At the Hutton office in Lansing, plaintiff was introduced to Joseph Potvin as "an expert in tax shelter investments". Mr. Potvin currently an assistant vice-president of Hutton, was then an account executive with considerable training and experience in the area of tax shelter investments. Mr. Potvin, a 1972 graduate of Michigan State University, was then and is now the tax shelter coordinator for the Lansing office. As tax shelter coordinator, Mr. Potvin received extensive training in the tax shelter investments area and was charged with the responsibility of training account executives in the Lansing office. Mr. Potvin had, earlier in his career, worked for

Merrill Lynch. Mr. Potvin is a member of the New York Stock Exchange, The American Stock Exchange and the National Association of Security Dealers in America.

Upon their meeting, or shortly thereafter, plaintiff related to Mr. Potvin his financial situation including his current professional corporation income of $500,000. Plaintiff emphasized to Mr. Potvin his desire to mitigate the tax burden he would incur due to the receipt of the contingency fee in one lump sum. Early on in their relationship, Mr. Potvin recommended to plaintiff that he enroll in Hutton's Personal Financial Management (PFM) program. The PRM program involves a comprehensive analysis of a customer's financial and estate situation including investment goals. Plaintiff declined to enroll in the PFM program viewing the $5,000 fee as prohibitive and stating that he thought he could do much of the work himself. Mr. Potvin also recommended that

plaintiff seek the advice of a certified public accountant and specifically suggested a Lansing C.P.A. named James Briley, to assist in preparing plaintiff's tax returns. Again, plaintiff declined. It was his belief that he had always prepared his own taxes and again was apparently reluctant to pay anyone else for tax advice.

Prior to contacting Hutton, plaintiff, on his own, had done some oil and gas lease investigation. There was testimony that plaintiff had investigated at least two oil and gas offerings related to developmental wells. Plaintiff decided not to invest in these programs for they lacked the "diversity" that exploratory programs offered. However, plaintiff remained interested in oil and gas and sought to pursue exploratory offerings through Hutton. At one of their early meetings, plaintiff specifically requested information from Mr. Potvin regarding oil and gas investments

handled by Hutton. Prior to plaintiff's first investment in an oil and gas program, Mr. Potvin discussed with plaintiff the relative advantages and disadvantages of alternate investments. In particular, plaintiff and Mr. Potvin discussed and compared oil and gas, municipal bonds and real estate limited partnership investments. Plaintiff was provided with a copy of a Hutton brochure entitled, "Understanding Tax Shelters", which describes the tax advantages and risks associated with various tax shelter investments, including cattle, equipment lasing, real estate and oil and gas.

Upon analysis, plaintiff concluded that neither municipal bonds nor real estate limited partnership investments suited his particular need for immediately high tax loss write-offs such as those available through investments in oil and gas. Accordingly, plaintiff chose to invest in oil and gas to the relative exclusion of alternate

investments with the exception of two real estate tax shelters which are not involved in this action.

Plaintiff purchased interests in the following oil and gas shelter limited partnerships ("Litigated investments") on the date indicated for the following initial amounts:

Investment Program	Date of Purchase	Investment Amount
Forest 81A	15 Dec 1980	$ 10,000
Hilliard 81	11 Feb 1981	10,000
Indian Wells 1981-I	2 Feb 1981	150,000
Can Am 81-I	11 Mar 1981	10,000
Woods	11 Mar 1981	10,000
Apache I1-I	31 Mar 1981	5,000
Sanchez-O'Brien 81-I	9 Jun 1981	10,000
Forest 81-B	9 Jun 1981	10,000
Kenai-81-2	18 Jun 1981	10,000
Woods 81-II	26 Jun 1981	10,000
Woods 82-III	29 Nov 1981	10,000
		245,000

Plaintiff testified that he read the prospectus which had been issued for each of these investments, although he claims that he read earlier ones more carefully than later ones.

Plaintiff told Mr. Potvin that he wished to be informed of each oil and gas opportunity as it became available. Accordingly, Mr. Potvin sent to plaintiff each of the offering documents when it was "hot off the press" and, invariably several weeks before the purchase date. Plaintiff upon review of the material often decided to invest in these programs and submitted the required paper work to Mr. Potvin days or weeks in advance of the program closing date with instructions to Mr. Potvin to forward the plaintiff's application to the sponsor as late as possible so as to retain and maximize his interest bearing money. Hutton is not a sponsor or general partner of any of the litigated oil and gas Limited Partnerships.

Plaintiff's first investment in oil and gas was made in December of 1980. Mr. Potvin supplied plaintiff with a prospectus for Forest 81-A, a public drilling program. Plaintiff received this prospectus and according to his testimony, read it "cover to cover". Forest 81-A was a first time offering by Forest Oil, the general partner. At the time that plaintiff studied the prospectus, he recognized the fact that there was insufficient information such as a track record to judge the quality of the offering for the likelihood of success. There was conflicting testimony about the conversation and representation made back and forth between Mr. Platsis and Mr. Potvin concerning this Forest Oil investment. The court is satisfied there were no actionable misrepresentations or omissions made by Mr. Potvin prior to plaintiff's investment in this program. Despite the "deficiency" which plaintiff discovered in the prospectus, he

nevertheless chose to invest in Forest 81-A apparently due to his overriding desire for tax write-offs. On June 9, 1981, plaintiff decided to invest in a second Forest program title Forest 1981-B and subsequently notified Hutton of his decision after it had been made.

After plaintiff had made his initial investment in Forest 81-A in the amount of $10,000, but before any additional investments, Mr. Potvin invited plaintiff to attend a seminar at Long's Convention Center in Lansing. This was sponsored by representatives of Can Am Drilling Program Inc. ("Can Am"), a corporate sponsor and general partner of several oil and gas limited partnerships. This seminar was held either in late December of 1980 or early January of 1981. At the Can Am meeting, plaintiff received a handout prepared by Can Am representatives. The handout included an article in Forbes magazine and responses to

that article prepared by Hutton and Can Am. The Forbes article was entitled: "But Where are the Limited Partners' Yachts?" The article, (offered and received as plaintiff's exhibits 87-88, 571-594) raised concerns regarding oil and gas limited partnership investment returns and included an analysis of prior Can Am programs. Plaintiff testified that he read and understood the article and the issues raised therein.

By this time at least it is clear from the evidence that plaintiff was an intelligent, inquiring, knowledgeable student of oil and gas offerings. He freely admitted that even at this early date he was critical in the remaining ten investments because they did not include, among other things, rates of return of income to limited partners in prior programs offered by the same sponsor and projections as to the future of the programs about to be formed. Plaintiff conceded he was also aware of and critical of the

structure of the program with respect to allocation of risk and reward between the limited partners and the general partners. It was also, at about this time, in early 1981, plaintiff contacted other non-brokerage sellers of interest in single oil well deals but decided to do all of his investing through Hutton. Plaintiff testified on a number of occasions that he had been impressed with Hutton's advertising that when "Hutton speaks, people listen" and further because of Hutton's reputation concerning its expertise, integrity and stature in the tax shelter industry. Plaintiff was also attracted to Hutton because of Hutton's suitability investigation of each sponsor before each offering was made to investors.

Plaintiff's second investment was in Hilliard 81. Prior to this investment, he insisted that Mr. Potvin provide him with reserve reports from prior programs sponsored by Hilliard Oil and Gas Inc., the

partnerships' general partner. From the reserve reports plaintiff concluded that he would be able to calculate the limited partners' rates of return on investment in the prior programs sponsored by Hilliard. Plaintiff requested the reserve reports at least four times prior to his investment in Hilliard 81 and stated he was "frustrated" because of lack of information but nevertheless, made his investment.

Plaintiff thereafter invested in eight more publicly offered oil and gas limited partnerships over the course of a year and a half. It is undisputed that plaintiff received all offering documents prior to investment. As previously indicated, he testified that he read the earlier documents "cover to cover" and perhaps the later ones in less detail. Further, plaintiff acknowledged that these documents concerning each of the programs contained numerous warnings such as the high risks involved in

the investments; that an investor should not rely on the past performance of programs of the same sponsor as indicative of the future performance of the current programs; also, that no one was authorized to make oral representations regarding the programs and that an investor should rely solely on the written offering materials in making his investment decisions.

In addition, plaintiff warranted in writing with regard to each program in which he invested that he was making his investment based on the written offering materials alone and was not investing in reliance on any oral communication that may have been made regarding the program. Further, he warranted that he was aware of the specific risks noted in the offering materials and the general risks of losing all his money and/or an unfavorable change in the tax laws with respect to write-offs.

Concerning plaintiff's final investment, made in Woods 82-III on November 10, 1982,

plaintiff testified that sale was made by direct communication between him and the program sponsor. That is, plaintiff bought this investment strictly on his own. It was only after the decision was made and investment paid was Hutton informed of plaintiff's investment. It is undisputed that Hutton was not involved in plaintiff's purchase of Woods 82-III.

As previously mentioned, ten of plaintiff's eleven investments were publicly offered partnerships. Plaintiff did, however, invest in one privately offered partnership, Indian Wells Drilling Partnership 81-I. Plaintiff's Indian Wells investment was the single largest investment plaintiff made. It was purchased on February 2, 1981.

Prior to plaintiff's receipt of the Indian Wells offering materials an internal Suitability Questionnaire (Plaintiff's Exhibits 198-199) regarding plaintiff and his

financial condition was sent to plaintiff. Although there was conflicting testimony concerning this particular document, it is apparent that it was filled out jointly by the plaintiff and Mr. Potvin. Further, the items that were filled out on the questionnaire and in Mr. Potvin's handwriting were the result of his questioning of the plaintiff. This suitability questionnaire is necessary to determine plaintiff's suitability to receive the offer pursuant to Rule 146, private offering exemption under the Security Act of 1933. (17 C.F.R. 230-146). At the time of filling out of the Suitability Questionnaire, Mr. Potvin was familiar with plaintiff's financial and investment background by direct experience in handling plaintiff's accounts. At the time of filling out of the Suitability Questionnaire, the court is satisfied from the evidence that Mr. Potvin believed the information therein to be accurate and had reasonable grounds to believe that plaintiff

was in fact suitable. The completed questionnaire was forwarded to Hutton in New York.

Plaintiff was deemed suitable to receive the offer pursuant to Rule 146 and thereafter received the Indian Wells Private Placement Memorandum. (PPM). Based on the PPM, plaintiff chose to invest $150,000 in Indian Wells 81-I. In order to meet the sponsor's suitability requirement, plaintiff completed and signed an offeree questionnaire (Exhibit HHP 16253-16258). In the course of filling out this offeree questionnaire, plaintiff represented by his "X" on page two of the document that his income for the tax year 1980 was $75,000-$100,000. Further plaintiff, on the same document, specifically declined to use the services and advise of an accountant in general and an offeree representative in particular and represented to the sponsor that no such assistance was necessary.

At some point of time in the suitability analysis by the sponsor, it was realized that the plaintiff's representation as to income for the past year did not satisfy the Michigan Uniform Securities Act requirement for exempt transactions (i.e., that the investor's income exceed $100,000 "for his last fiscal year or latest twelve (12) month period.") M.C.L.A. 451801(b)(9)(5) (ii). This concern was passed on to Mr. Potvin who contacted Mr. Platsis. Mr. Platsis then wrote a letter to Marian Sanvey, the attorney for Indian Wells, representing that his income for the calendar year 1980 was in excess of $100,000. That letter states, "In reference to my purchase of Indian Wells 81-1 drilling program, I hereby state that my total gross income for the calendar year 1980 was in excess of $100,000.00." (Exhibit IW-13).

Concerning the investment in Indian Wells, Mr. Potvin further advised plaintiff

that he could use a Letter of Credit by which his cash investment would be limited to $50,000 and his write-offs would be based on a $150,000 investment. Mr. Potvin then arranged a meeting with a banker, James Allen, to facilitate obtaining a Letter of Credit. This advice, however, was rejected by plaintiff who decided to pay cash because he did not want to pay interest on the letter of credit.

As a result of his investments, plaintiff participated in over 500 separate wells in 11 different states. They were equally divided between "low risk-low reward developmental wells" (drilled into known oil and gas reserves) and "high risk-high reward exploratory wells) drilled outside of the fringes of known reservoirs. It is undisputed that the choice to buy each of the 11 litigated programs was that of the plaintiff. These wells were drilled during the years 1981 through 1985 inclusive. As

anticipated, as a result of these investments, plaintiff took substantial write-offs from his taxes in 1980, 1981, and 1982. In 1981, when nine of the eleven investments were made, plaintiff wrote off approximately $190,000. On average, fifty percent of all wells drilled resulted in production. Woods Petroleum and Indian Wells experienced a success rate of over eighty percent.

Plaintiff invested a total of $276,132 in all. $235,000 by July, 1981; $32,000 by the end of 1982; and $9,000 through 1985.

After five years, plaintiff received cash distributions of $77,270.17. He deducted eighty-three percent of his investment dollars from his taxable income. According to plaintiff's testimony at trial, the present value of reserves remaining in all of his programs (apparently four of eleven are now bankrupt) total $23,000 after taxes.

It is the claim of plaintiff that Mr. Potvin made a number of misrepresentations to him from October, 1980 to July, 1981, concerning gas and oil investments which representations were false and made recklessly and willfully. In addition, plaintiff claims that he relied on these false statements to his detriment and that the defendant Hutton is liable for Mr. Potvin's misrepresentations.

Despite this court's repeated advice to Mr. Platsis during the pretrial phase of the case that he obtain counsel, he preferred to handle the case himself. As a result, during the trial it was frequently difficult for the court to determine when Mr. Platsis was testifying as a witness under oath and when he was arguing some point in his capacity as his own lawyer.

Further, his proofs, arguments, as well as his briefs were rambling, poorly

organized,* and often obtuse. Frankly, it has been extremely difficult for the court to determine just what specific conduct of the defendant and/or statements Mr. Platsis takes exception to. As best as can be reconstructed, plaintiff claims he told Potvin that after 1981, he expected his income to be in the range of $50,000 a year indefinitely. Further, that Potvin told him: "Oil and gas is for you, that's the thing

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* Lord Birkett, the famous British Barrister reminds us in his book <u>Six Great Advocates</u> of a comment a British Judge once made to an attorney presenting a bewildering array of facts with little or no order:

> 'Mr. Smith, do you not think by introducing a little order into your narrative you might possibly render yourself a trifle more intelligible? It may be my fault that I cannot follow you - I know that my brain is getting a little dilapidated; but I should like to stipulate for some sort of order. There are plenty of them. There is the chronological, the botanical, the metaphysical, the geographical, why even the alphabetical order would be better than no order at all.'

that's going to preserve your assets"; "oil and gas shelters are superior to owning municipal bonds"; "E.F. Hutton sponsors programs which average returns of $3.00 for every $1.00 invested for six to ten years"; "the SEC prohibits the disclosure of reserves discovered in prior programs of the sponsor whose program is under consideration"; "You have to rely on us, E.F. Hutton is too big, it wouldn't bring junk to the market". Further, plaintiff alleges Mr. Potvin misrepresent return on municipal bonds at only five percent rather than at ten, eleven and twelve percent, tax free. Platsis further claims that he told Mr. Potvin that he couldn't analyze the prospectus issued by the various issuing sponsors because they didn't contain reserve data and Potvin replied, "We have torn these companies apart and put them back together again, nobody understands them better than E.F. Hutton"; and finally, investors were told that

Hutton's due diligence efforts have "paid attention to every detail". Platsis says he told Potvin to treat him "like a little old lady".

In addition to verbal misrepresentations, plaintiff claims the oil and gas programs he purchased were economic disasters from the beginning and this was known to Hutton. It is plaintiff's claim that purchasers should have been warned "you <u>will</u> lose all your money", rather than "you <u>may</u> lose your money"! Plaintiff claims further he was unsuited by knowledge, education, training and/or investment experiences to evaluate the merits and risks of oil and gas investments. Further, that no investor, except an insider, is capable of evaluating the merits of oil and gas investments from the prospectus alone "because the economic merit of wells to be drilled and past total performances in meaningful terms is not disclosed in the

prospectus." Further, Mr. Potvin said, in essence, that limited partnerships were good investments; that investors would have to rely upon the knowledge, skill and integrity of Hutton; that Hutton knew reserve data through its due diligence work but plaintiff could not see them as they were confidential. Finally, plaintiff claims that defendant (or Mr. Potvin) falsified plaintiff's in-house suitability questionnaire. Plaintiff called Claude Osbourne, former officer, Dart Energy Corporation of Michigan as an expert witness. He concluded from a review of the Indian Wells documents that it was not a sound economic investment. Osbourne also reviewed the other oil and gas investments of plaintiff and likewise concluded they were economically unsound. He criticized the practice of escalating oil prices in estimating future returns. Further, he stated that for an investor to obtain a competitive and adequate return he should

receive $4 for each dollar invested. None of plaintiff's programs met this criteria. Some sponsor materials did include "track records" but according to Osbourne it was so complicated it, in effect, was non-understandable. In conclusion he stated he, himself, would not have made the investments. Plaintiff also called Ted Bien, a stock broker who is familiar with oil and gas training and sales priorities. Although describing in general Hutton's instructions to its sales force, his testimony shed little light on the validity of plaintiff's claims. Eric Dawe, also a stock broker, was likewise called by plaintiff. He concluded plaintiff was unsuitable for multiple purchases of oil and gas investments in that his income was too low and that one year of a "spiked" income was inappropriate for these investments. Further, plaintiff' money should have been invested in diversified programs that would

not all respond in the same way to unforeseen economic and political events. Finally, he stated that high risk programs should not represent more than 30 percent of one's portfolio, not two-thirds to three-quarters as in plaintiff's situation.

In response, Hutton denied Mr. Potvin made any false or actionable representations. That plaintiff was a knowledgeable investor, knew full well the risks inherent in oil and gas programs and made his own investment decisions and is now trying to hold someone else responsible for what, by hindsight turns out to be unwise investment decisions. In addition, Hutton submitted proof that before offering the limited partnerships for sale, it engaged in a four-phase due diligence program comprised of review from "initial due diligence," to Underwriting Committee review to final review by experts. [Plaintiff's Exhibit 43; Testimony of Mr. Holmes]. At phase four of the due diligence program,

Hutton engaged the services of accountants, lawyers, private investigators and independent petroleum geologists and engineers. One of Hutton's witnesses, Michael Holmes, was one such engineer. He has a Doctorate in Geology from University College, London, a Masters of Science in Petroleum Engineering from the Colorado School of Mines, 25 years of experience in the private sector with corporations such as British Petroleum and Marathon Oil. The engineers examined sponsor files, questioned sponsor personnel and assessed the economic viability of each program, reporting the results to Hutton both orally and in writing. [Exhibits HPP 134970-135008; HHP 16439-16445]. While some programs were rejected for various reasons during this review and were, therefore, not offered by Hutton, the eleven involved in this case were judged to be economically viable in the economic environment which existed in the

1980 and 1982 period. The Hutton review process was described by Mr. Holmes as "state of the art" at the time. As stated in its brief Hutton alleges this is a case of disappointment rather than deception. That the investments were made just prior to a precipitous and unexpected decline in worldwide prices for oil and gas, which decline had a dramatic effect on the value of plaintiff's investments.

It is the claim of plaintiff that Hutton is liable to plaintiff for violating section 12(2) of the Securities Act of 1933; Section 10 of the Securities Exchange Act of 1934 and Rule 10b-5; the Michigan Consumer Protection Act; section 410(a) of the Michigan Uniform Securities Act; breach of contract, breach of fiduciary duty and violation of the Racqueteer Influenced and Corrupt Organization Act (RICO).

A. ALLEGED VIOLATION OF SECTION 12(2) OF THE SECURITIES ACT OF 1933.

1. <u>Statute of Limitations</u>

Count I - alleges a violation of Section 12(2) of the Securities Act. Liability under this section attaches to one who offers or sells security by means of a prospectus which includes "an untrue statement of a material fact or omits to state a material fact necessary in order to make the statement . . . not misleading . . . " without proof of reliance or surrender. Sanders v John Nuveen & Co., Inc., 619 F.2d 1222.

Based upon the evidence adduced at trial and the applicable law, I am satisfied that all plaintiff's claims under Section 12(2) of the Securities Act of 1933 are barred by the one year limitations of Section 13 of the Act. To be timely, the Section 12(2) claim must have been brought within one year after the alleged misrepresentations and omissions were discovered or reasonably should have been discovered. Section 13 of the Securities Act of 1933, 15 U.S.C. Section 77m.

As previously noted plaintiff's first ten (10) investments were made from December, 1980, to June, 1981, and his complaint in this action was filed in June of 1983.

The evidence is undisputed that plaintiff had actual knowledge at the time he made his purchases of the alleged omission of prior programs rates of return to limited partners and future program projections. He was aware of these omissions and complained about them prior to his purchase of the first investment in December of 1980.

Plaintiff argues strenuously that a fraud was committed upon him because the prospectus in each of the programs in which he invested did not contain reserve reports. Further, that after a year or two when he did obtain reserves, they were incorrectly reported and "concealed economic disaster". However, as previously noted, before investing plaintiff recognized the uncertainty of the venture when he realized

no reserves were described in the prospectus put out by the various issuing sponsors. Plaintiff relies upon an unsworn internal Hutton memo, (Jordan Letter) to support his claim of fraud. Admittedly, it refers to unhappy investors who lost money on oil and gas tax shelters. However, that is a far cry from proof of fraud. Before plaintiff invested one dollar in any program, he complained bitterly to Mr. Potvin that the programs did not disclose reserves. Plaintiff has offered no proof that in offerings of this nature, a standard of due care required that reserves be disclosed. (In most new partnerships, no proved reserves were in fact "known" at the time of the offer). Platsis understood this. He was not mislead. He was free to invest elsewhere. Nevertheless, prompted by an overriding desire for a tax write-off he recklessly jumped in anyway.

Plaintiff purchased his eleventh program, Woods 82-II in November of 1982, outside the Hutton system, and, no representations could be said to have been made as to this separate investment.

With respect to all claimed omissions and misrepresentations, the evidence shows that plaintiff should have discovered what he now complains of in the exercising of reasonable diligence long before one year prior to his filing of the action on June 23, 1983. In determining whether an untrue statement or omission should have been discovered by reasonable diligence, the following points are relevant:

1. Plaintiff need not know all of the facts which establish that an untrue statement or omission has been made before the one year period starts to run. Ingenito v. Bermac Corp., 411 F. Supp 525 (S.D. N.Y. 1977);

2. When plaintiff has enough facts in his possession to make him suspicious or that ought to make him suspicious, he is deemed to be on inquiry notice of his claim and the one year period will begin to

run at that time. Buder v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 644 F.2d 690, 693 (8th Cir. 1981); Ingenito v. Bermac Corp., 411 F. Supp 525 (S.D. N.Y. 1977); Maine v. Leonard, 365 F. Supp. 1277, 1281-1282 (W.D. Va. 1973); Krasman v. Security Gas & Oil, Inc., 672 F.2d 766, 771 (9th Cir. 1982), cert. denied 459 U.S. 1035 (1982);

3. Whether plaintiff should be suspicious is to be tested whether a reasonable person with the same experience and background of the plaintiff and with knowledge of the same facts as were known to the plaintiff would be expected to be suspicious and to make inquiry. Ingenito v. Bermac Corp., supra.

4. Whenever plaintiff in the course of the purchase of a security receives oral representations from the seller which are directly contrary to the written representations contained in the offering material, he will be deemed to be on inquiry notice from the moment of the sale. Kennedy v. Josephthal & Co., Inc.,(CCH) Fed. Sec. L. Rep. Section 99,653 (D. Mass. 1984); Cook v Avien, Inc., 573 F.2d 685 (1st Cir. 1978).

Kennedy v. Josephthal & Co. Inc., supra, is particularly pertinent to the instant action. It holds, as a matter of law, when the purchaser of a security receives oral

representations contrary to the written representations in the offering materials he is on inquiry notice as of the time the discrepency becomes apparent, that is, upon receipt of the offering materials. The principal is exemplified in this action which plaintiff suggests that Mr. Potvin did something akin to promising him "guaranteed" returns on his investments. As previously noted, Mr. Platsis read the initial prospectus from "cover to cover" and being a lawyer and becoming more expertise all the time in oil and gas leases, he clearly understood the various warnings. He makes no claim to the contrary. The financial risks repeatedly and plainly set forth in the offering materials are wholly inconsistent with any promise of "guaranteed" returns. Each offering document highlights the fact that the investor could in fact lose all of his money. Likewise, the investor was specifically advised that he must not rely

upon any oral representation. Consequently, upon receipt and review of the materials, plaintiff unquestionably knew or certainly should have known that any suggestion of a promised return, if actually made, was made without any factual basis, was of questionable merit and potentially false. At that time, the statute of limitations began to run with respect to those alleged representations. The burden of proving compliance with the statute of limitations is upon the plaintiff. It is his burden to prove by a preponderance of the evidence that he did not discover and through the exercise of reasonable diligence could not have discovered that misrepresentations or omissions were made until some time within the twelve (12) months preceding the commencement of the action. This, plaintiff has not done.

Although I am satisfied the Section 12(2) claims are barred, nevertheless, I am

also convinced from the evidence that defendant did not, in fact, commit Section 12(2) violations.

2. Alleged Oral and Written Misrepresentation

Plaintiff argues that Hutton's account executive, Joseph Potvin, violated Section 12(2) of the Securities Act of 1933 and that Hutton shares responsibility for the violation under the theories or respondeat superior, aiding and abetting and control person liability. Plaintiff testified that in the course of offering the litigated investments, Mr. Potvin made certain statements to him that the plaintiff believes to be false and that Mr. Potvin provided him with written materials which contained misrepresentations.

First, it should be noted that written misrepresentations outside of the prospectus are not actionable by Section 12(2) of the Act. Section 12(2) of the Act which covers oral and written misrepresentations, or

omissions are limited to the prospectus. Thus, any written misrepresentations which occur outside the prospectus are not actionable under Section 12(2). Plaintiff testified that he received the reserve reported dated March 25, 1981, regarding prior Indian Wells programs but that such reports were delivered after his investment in Indian Wells. Claims based on such receipt are not actionable. With respect to the Hilliard reserve numbers, plaintiff's testimony reveals that he "may" or "may not" have received the Hilliard reserve reports prior to his investment in the Hilliard program. The admission regarding the Indian Wells reserve reports and plaintiff's inability to recall when he received the Hilliard reports satisfied the court that plaintiff has failed to prove his claim in connection with written misrepresentations. See Marsh v. Armada Corp., 533 F.2d 978, 982, n.e, (6th Cir. 1976), cert. denied. 430 U.S.

954 (1977). "Standing is not awarded a plaintiff if his purchase or sale occurs before the alleged [wrongful] conduct."

With regard to the alleged oral misrepresentations claimed to have been made by Mr. Potvin, I find that plaintiff failed to meet his burden of proof by a preponderance of the evidence that the representations were made much less false.

Plaintiff has also failed to prove that the representations, if false, constitute actual misrepresentations of fact. To be actionable, misrepresentations generally must relate to an existing or pre-existing fact which is susceptible of knowledge. Higgins v. Lawrence, 107 Mich. App. 178, 309 N.W.2d 194 (1981); 37 Am.Jur.2d Fraud and Deceit Section 45. A statement of opinion or belief such as occurs in "puffing" generally cannot constitute a misrepresentation. W. Prosser, The Law or Torts, Section 10.9, at 726 (4 ed. 1971).

Furthermore, projections and financial forecases made on a reasonable basis are not actionable merely because they may ultimately prove incorrect. Polin v. Conductron Corp., 552 F.2d 797 (8th Cir. 1977), cert. denied, 434 U.S. 857 (1977); Lucas v. Florida Power & Light Co., 575 F. Supp. 552, 569, (S.D. Fla. 1983). And as a general rule, an honest but mistaken estimate as to the value of a business is generally considered to be an opinion and not an actionable misrepresentation. Essenburg v. Russell, 346 Mich. 319, 78 N.W.2d 136 (1956).

To be actionable, the alleged misrepresentations must be "material." A fact is "material" if it is substantially likely that a reasonable investor would consider the matter important in making an investment decision. S.E.C. v. Washington County Utility District, 676 F.2d 218 (6th Cir. 1982). Whether or not the misrepresented or omitted fact is important

turns on objective determination of whether a reasonable investor would regard it as significantly altering the total mix of information made available to him. Austin v. Loftsgaarden, 675 F.2d 168, 176 (8th Cir. 1982).

In this case, reserves were not disclosed initially. Plaintiff understood the significance of not having that data. He complained. He go not satisfaction. Yet, he invested anyway. If blame is to be assessed, he has only himself to blame. Nor has plaintiff produced evidence for the court to find that a reasonably prudent investor would consider the alleged misrepresented matters important in making an investment decision.

For the foregoing reasons, plaintiff has failed to prove that Hutton's Account Executive, Joseph Potvin, violated Section 12(2) by virtue of oral or written misrepresentations of material facts in the sale of the litigated partnership interests.

Furthermore, plaintiff has also failed to prove that Hutton should share liability for any violation of Section 12(2) that Mr. Potvin's actions may have precipitated. As noted, plaintiff's claims against Hutton regarding alleged oral or written misrepresentations by Mr. Potvin (plaintiff's claim for secondary liability) is founded on the theories of respondeat superior, aiding and abetting and control person liability pursuant to Section 15 of the Securities Act.

Plaintiff, in effect, abandoned these theories at trial, having produced no evidence regarding them whatsoever. Plaintiff has not proven that Mr. Potvin's alleged actions were within the scope of his authority as a Hutton Account Executive, as liability under the theory of respondeat superior would require. In fact, the evidence shows that by virtue of statements within the offering documents read by plaintiff, plaintiff was aware that

Mr. Potvin had no authority to make oral or written representations. Plaintiff's knowledge of Mr. Potvin's limited authority precludes liability against Hutton on the respondeat superior theory. Holloway v. Howerdd, 536 F.2d 690 (6th Cir. 1976); 329 N.W.2d, 824, 827 (Minn. 1983); Restatement of the Law of Agency 2d, Section 1662 and Section 260.

In addition, plaintiff has failed to prove that Hutton as an entity knowingly and substantially assisted in a violation of Section 12(2). Accordingly, no liability can be found against Hutton under the aiding and abetting theory. S.E.C. v. Coffey, 493 F.2d 1304, 1306 (6th Cir. 1974), cert. denied, 420 U.S. 908 (1975).

Finally, plaintiff produced no evidence that Hutton actually participated in and exercised control over the operation of Mr. Potvin or that Hutton possessed the power to control the specific transaction or activity

which allegedly constitutes the violation of Section 12(2), each as required by Section 15 of the Act for the assertion of control person liability. Accordingly, Hutton cannot be held liable for any violations of Section 12(2) that may have been committed by Mr. Potvin.

3. Alleged Omissions.

Plaintiff alleges that the offering materials were misleading because they omitted to state material facts necessary to make the statements that were made not misleading. Specifically, plaintiff alleges that the following facts were omitted from the offering materials:

> (1) The Rate of Return or Return on Investment that limited partners in prior sponsor programs realized or would realize (or reserve data and production scheduling from which such returns could be calculated); and
>
> (2) Projected reserves of the partnership in formation.

As previously indicated, the evidence in this case demonstrates, beyond any doubt,

that the plaintiff was aware of the above alleged omissions prior to his investment in any of the litigated investment programs. Plaintiff's knowledge of the omissions is alone fatal to his claim.

Further, plaintiff has failed to prove that the above omissions were material. Evidence in the record convinces the court that information regarding the past performance of unrelated partnerships and "speculative projections" are not the type of facts that would, in the mind of an ordinary reasonable investor, be important in making his investment decision.

The inclusion of information regarding prior program performance, whether in the nature of rate of return or reserve calculation, coupled with the implication that it is reasonable for an investor to rely on the information as an indication of future program performance could itself be misleading. The past performance of prior

sponsor programs, which involve different leases perhaps in different states, is in no way an indication of how the partnership in formation will fare. As demonstrated at trial, the inconsistent results of prior Woods programs demonstrates the folly of projecting a return for a new program based on a prior program.

Plaintiff argues that guidelines of the North American Security Administrators Association require disclosure of certain information regarding the past performance of prior programs of the general partners. It should be noted that these guidelines were not adopted in Michigan until the spring of 1983, after plaintiff's investments. Accordingly, they cannot be deemed binding at the time of plaintiff's investment.

More importantly, the guidelines do not require the disclosure of that which plaintiff complains. The guidelines specifically provide, at Section X(B), that

with respect to offerings registered with the S.E.C., a filed prospectus "shall be deemed to comply with all requirements as to form of these guidelines; provided, however, that the Administrator reserves the right to require additional disclosure of substance in his discretion." the guidelines simply suggest the type of information that should be disclosed regarding the part performance of prior partnerships of the general partners "when required or permitted by the [state] administrator." See Section X(C) (k), Statement of Policy for Registration of Oil and Gas Programs, currently reported at Blue Sky L. Rep. (CCH) paragraph 5231 at p. 1237 (1985). In other words, the individual state administrator would have to make an independent judgment that such disclosure was appropriate before the disclosure would ever be "required" under the guidelines. Also it is noted that when the guideline disclosure in mandated, the guidelines themselves

require that the following caveat be "prominently featured" in the presentation of the past performance information:

> It should not be assumed that participants in the the offering covered by this Prospectus will experience returns, if any, comparable to those experienced by investors in the prior program. Section X(c) (k) (4).

The necessity of this disclaimer highlights the fact that information regarding the performance of prior partnerships of the general partner is not material and may in fact be misleading.

As a secondary argument, plaintiff claims that reserve reports of prior programs should be disclosed so that the rate of return to limited partners of the prior programs may be calculated. Again, it should be noted that rates of return are not material as indicative of the future performance of the partnership in formation. More importantly, during the period in which plaintiff invested in the litigated oil and gas limited partnerships (December 1980 to

November 1982), the S.E.C.'s Rules, Regulation and Forms did not require that a registration statement or private placement memorandum or other offering material of an oil and gas limited partnership include disclosure of oil and gas reserve data with respect to prior limited partnership for which the prospective general partner had acted as a general partner. Indeed, oil and gas limited partnerships are and were specifically exempt from quantity reporting in offering documents. See, generally Form S-1 [registration statement form] (CCH) Fed. Sec. L. Rep. paragraph 7121-7126; Item 102 of Regulation S-K [nonfinancial statement disclosure rule] 17 C.F.R. Section 229.102 (1985); and [industry Guideline -- Disclosure of Oil and Gas Operations] CCH) Fed. Sec. L. Rep. paragraph 3826 [former Item 2, Regulation S-K].

Current Industry Guide 2, supra, requires disclosure of certain information

regarding the past performance of corporations in oil and gas business, but provides an exemption from the disclosure requirements thereof for limited partnerships that conduct oil and gas drilling programs. The same exemption was contained in Item 2 of Regulation S-K effect from 1978 until 1982 when the provision was deleted from Regulation S-K and placed in Guideline 2 in a revision adopted in Securities and Exchange Commission Release N. AS-306, effective May 24, 1982. Item 2 of Regulation S-K, in effect at the time plaintiff made his investments, provided in relevant part as follows:

Regulation S-K

* * *

(b) If oil and gas operations are material to the registrant's and its subsidiaries' business operations or financial position, disclose the following under appropriate caption (in tabular form if practicable, and with cross reference, where applicable, to related information disclosed in financial statements):

<u>General Instructions</u>

Instruction 1: <u>Limited partnerships or joint ventures that conduct, operate, manage or report upon oil and gas drilling or income programs which acquire properties either for drilling and production, or for production of oil, gas or geothermal steam or water are not required to include the information specified by this Item 2(b)</u>. (Emphasis added).

* * *

Instruction 4: <u>Estimates of probable or possible reserves and any estimated value thereof shall not be disclosed in any document publicly filed with the Commission</u>. (Emphasis added).

2(b)(1)(i) As of the end of each of the last five fiscal years, (but not for fiscal years ending prior to December 25, 1978), estimated net quantities of: (A) proved oil and gas reserves; (B) proved developed oil and gas reserves; (C) oil and gas applicable to long-term supply or similar agreements with foreign governments or authorities in which the registrant acts as produced; and (D) the registrant's share of reserves of investees accounted for by the equity method.

(ii) For each of the net quantities reported, the present value of estimated future net revenues, computed in accordance with Regulation S-X, Section 210.3-18(k) (6).

As a matter of law, materials specifically exempted from disclosure by the Securities and Exchange Commission cannot, by their omission from offering documents, form the basis of a 12(2) violation. At the very

least, the existence of the exemption is evidence that the information sought by plaintiff is not "material" and probably misleading.

Plaintiff claims a "material omission" from the offering memoranda, arguing that the memoranda should have, but did not, include estimates of reserves and the present value of those estimated reserves, thus giving the offerees an opportunity to assess the economic viability of the programs and compare them with other potential investments.

Legally, there is no requirement that a sponsor include such information in an offering memorandum. Factually, to do so is dangerous and may well mislead potential investors.

Plaintiff himself offers the best argument against the use of such estimates in a prospectus. Because the partnerships had not been formed when the offers were made,

few, if any, leases had been identified to the programs, and in no case had wells been drilled. Consequently, the inclusion of estimates (perhaps more accurate - "guesstimates") of available reserves creates the potential to seriously mislead potential investors. Platsis was upset at the use of such estimated reserves in periodic reports received from sponsors. Platsis criticized the reports in the following language:

> And, more importantly, one-third of their reserves represented so-called undeveloped reserves, and they put the word "proved" in front of it.
>
> Now that is deceptive for the additional reason that that is just a fancy word for developmental wells to be drilled . . . . They really don't know if the geological structure ends five feet from the adjacent well or not, but they included them as part of the reserves.
>
> [B]anks never loan money on proved undeveloped reserves. They're too risky. Well, if banks won't loan money on it, why should it be reported to limited partners.

p. 4, 6, transcript of excerpts from plaintiff's opening statement.

Thus, Platsis criticized sponsor's reports to actual investors which are based on reserves which are "proved undeveloped," that is, not being presently tapped with existing wells - because they are "too risky." At the same time, he argues that the offering memorandum inviting new participants ought to contain such information. Platsis acknowledges that the reserves he would have disclosed in offering memoranda are, at best, "proved undeveloped" reserves.

The evidence establishes that preliminary estimates based on "proved undeveloped" reserves are "too risky," and, if included in offering memoranda, may tend to mislead investors. To avoid this dilemma, Hutton's testimony established that it took the position that it is preferable to warn potential investors that the programs involve a high degree of risk and are speculative; that there is a danger that no oil will be found and, even if found, might not be in

sufficient quantities to produce a profit; that other identified market risks, exist, and investors may well lose their entire investment.

Not only did the offering memoranda contain such explicit warning, Platsis acknowledges reading such warning before he invested. The warnings are conspicuous, clear and readily understandable. There can be no credible argument that Platsis was unaware of the risk before he invested.

Plaintiff further alleges that the prospectuses failed to disclose that the investments were "noneconomic". Plaintiff has failed to prove that the litigated partnership investments were in fact noneconomic and the evidence indicates they were economic at least in the environment in which they were offered.

Plaintiff's principal proof on the matter was offered by his expert, Claude Osbourne. Mr. Osbourne, plaintiff's

neighbor, was an officer of Dart Energy Corp., a corporation which sought and denied Hutton's assistance in forming and marketing an oil and gas limited partnership. Mr. Osbourne did not testify that the offerings were worthless but only related his personal judgment that they did not offer a high enough potential return commensurate with the risks involved when compared to alternative investments without regard to the tax impact of such alternative investments. Mr. Osbourne in fact cited and adopted as accurate an article by Charles E. Ramsey, Jr., entitled "Economic Merits and Comparisons" [Plaintiff's Exhibit 197], which compares after-tax oil and gas investments with municipal bond investments and not only validates the former as "economic" but also proves the former viable in comparison with the latter. In sum, Mr. Osbourne testified merely that were it his money, he would have picked a different investment vehicle.

Hutton, through the testimony of Michael Holmes, an independent oil and gas consultant, offered proof that oil and gas investments were in fact, "economic" or at least had been during the seventies and early eighties when the price of oil was on the increase. Sales of tax shelters by Hutton grew steadily from 2.5 million in 1970 to almost 300 million in 1979. In a detailed analysis of the economics of oil and gas tax shelter, Frazier Stewart in Oil Drilling Programs, Stimulant to Oil Development, published in the Journal of Petroleum Technology which was offered as Exhibit 28, said as follows:

> "The exploration-oriented program carries a relatively high risk, the theory being that the tax-savings incentive provides relatively low-cost dollars for exploration, with the hope of finding large reserves that yield a high return. Of course, successful wells have to pay for dry holes, so results to investors on any one program can vary from nothing to a large return. ...

There is much uncertainty on the part of investors and securities houses as to the profitability of programs to investors. There is similar speculation within the petroleum industry and even by competitor program sponsors. As a matter of fact, some sponsors have not analyzed objectively their own past programs from their investors' standpoint.

Resource Consultants has analyzed the past performance of most public drilling programs, and as might be expected, the results of some programs are reasonable good, some mediocre, and some poor. A pre-tax return (net operating income ultimately returned to the investor divided by paid-in capital) of 1.0 to 2.0 is considered acceptable. After taking into account tax effects, the return for that range is more on the order of 1.25 to 3.5, assuming deductibility of 80 percent or more and a tax bracket of 50 percent or higher. ...

The consensus of leaders in the drilling program field is that growth of drilling programs will continue and that they will fill an important need for capital in petroleum exploration and production. Drilling programs are a means of mobilizing capital from investors into a job that must be done and for which Congress has authorized the long-standing incentives of expensing intangible

deductions and the depletion
allowance."

In addition, it was testified to by Mr. Holmes' that unanticipated economic conditions brought on a disappointing performance of plaintiff's oil and gas investments. That is, the value of the discoveries was less than the industry anticipated in the 1982 environment solely due to decreasing prices. At the very least, Hutton has established to the satisfaction of the court that through its due diligence reports it had a reasonable belief that the programs were economically viable under all the circumstances known to Hutton at the time of the offering. Plaintiff's three experts, only one of whom could legitimately be classified as an economic oil and gas industry expert, failed to convince me by a preponderance of the evidence, that the marketing of the oil and gas programs in which plaintiff invested constituted a

material misrepresentation or omission under Section 12(2).

B. ALLEGED VIOLATIONS OF SECTION 10 OF THE SECURITIES EXCHANGE ACT OF 1934 AND RULE 10b-5.

Plaintiff contends that by virtue of the same alleged oral and written misrepresentations referred to above, Hutton is liable for a violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 of the Securities and Exchange Commission. Plaintiff contends further that Hutton also violated Rule 10b-5 by perpetrating a "fraud on the market" in the sale of the limited partnership programs.

In contrast to 12(2) it is well established that to establish a violation of 10(b) of the Exchange Act, proof of scienter and reliance as well as material misrepresentations or commissions is required. _See_ _Ernest & Ernst_ v. _Hochfelder_, 425 U.S. 185.

(1) _Alleged Oral and Written Misrepresentations_.

Plaintiff argues that Mr. Potvin, by virtue of the alleged oral and written misrepresentations discussed _supra_, violated Section 10(b) and Rule 10b-5. Plaintiff also alleges that Hutton shares liability for the allege violation under principles of respondeat superior, aiding and abetting and control person liability pursuant to Section 20(a) of the Securities Exchange Act of 1934. In order to recover under Section 10(b) and Rule 10b-5 on the claim that affirmative oral or written misrepresentations existed in the purchases of the limited partnership interest, plaintiff must prove by a perponderance of the evidence; ...1) The use of jurisdictional means 2) to implement a deceptive or manipulative practice (with the requisite scienter) 3) in connection with 4) the purchase or sale 5) of a security 6) causing all damages. _Mansbach_ v. _Prescott, Ball & Turben_, 598 F.2d. 1017, 1026 (6th Cir. 1979).

I am satisfied plaintiff has failed to prove a violation of Rule 10b-5 based on alleged oral or written misrepresentations, i.e., plaintiff has failed to prove by a preponderance of the evidence that Hutton employed a deceptive or manipulative device in its dealings with plaintiff.

Additionally, plaintiff has failed to prove that Mr. Potvin acted recklessly, i.e., that Mr. Potvin's conduct was highly unreasonable, which constituted an extreme departure from the standards of ordinary care. Ohio Drill & Tool Company v. Johnson, 625 F.2d 738 (6th Cir. 1980); Ingram Industries, Inc. v. Nowicki, 502 F. Supp. 1060 (E.D. Ky. 1980); Sharp v. Coopers & Lybrand, 649 F.2d 175, 193 (3rd Cir. 1981), cert. denied 455 U.S. 938 (1982); Sunstrand Corp. v. Sun Chemical Corp., 553 F.2d 1033, 1045 (7th Cir. 1977), cert. denied, 434 U.S. 875, 98 S. Ct. 224, 54 L.Ed.2d 155 (1977).

Plaintiff has not only failed to prove scienter on Mr. Potvin's part, but virtually absolved him of all wrongdoing by testifying that Mr. Potvin "was a victim himself." Accordingly, plaintiff having failed to make a showing of scienter, may not recover for an alleged violation of Rule 10b-5 by means of oral misrepresentation.

Nor has plaintiff proven by a preponderance of the evidence that he justifiably relied on any misrepresentations that may have been made in connection with the litigated investment programs. To prove reliance, plaintiff must prove that the misrepresentation actually and reasonably induced him to act differently than he otherwise would have if the truthful fact had been disclosed and that by an objective standard such reliance was justified under all the circumstances. Schick v. Steiger, 583 F. Supp. 841 (E.D. Mich. 1984); St. Louis Union Trust Company v. Merrill Lynch, Pierce,

Fenner & Smith, 562 F.2d 1040, 1048 (8th Cir. 1977); cert. denied, 435 U.S. 925, 98 S.Ct. 1940, 55 L.Ed.2d. 519 (1978). Austin v. Loftsgaarden, 675 F.2d 168, 177 (8th Cir. 1982); Vervaecke v. Chiles, Heider & Company, Inc., supra. Proof of justifiable or reasonable reliance requires plaintiff to establish that he acted reasonably in believing and placing reliance upon the misrepresented fact. Vervaecke v. Chiles, Heider & Company, Inc., supra.

Where an investor is presented with oral representations in the offer or sale of an investment which conflict with written representations made in the Offering Memorandum, or where he is expressly warned in the Offering Memorandum that any oral representations contained therein are unauthorized and are not to be relied upon, it is not reasonable for an investor to rely upon such oral representation and as a matter of law. The element of justifiable reliance

is not satisfied. Zobrist v. Coal-X, Inc., 708 F.2d 1511, 1518 (10th Cir. 1983).

In this action, plaintiff was supplied with documents detailing the risks of investment. Plaintiff was informed that no individual was authorized to make representations involving the program and that he was to rely solely upon the written memorandum. Plaintiff, in fact, represented in a signed document addressed to Hutton and the sponsor that in making his investment decisions he did in fact rely solely upon the written offering memoranda. In view of plaintiff's sophistication, education, and admission that he read the materials "cover to cover", the court is not persuaded that he in fact relied on oral statements or, in any even, that such reliance, if any, was justified.

Although more properly a proportion relating to damages than causation, in order to recover under Section 10(b) and Rule

10b-5, plaintiff must prove by a perponderance of the evidence that his monetary loss, if any, was directly and proximately caused by the misrepresentations and omissions which he alleges were made. This causation requirement is satisfied in a Section 10(b) and Rule 10b-5 case only if the misrepresentation touches upon the reason or reasons for plaintiff's pecuniary loss. If the investment decision is induced by misstatements or omissions that are material and are relied upon by the claimant, but are not the proximate reason for his pecuniary loss, recovery under the statute and the rule is not permitted. Huddleston v. Herman & MacLean, 640 F.2d 534, 549 (5th Cir. 1981), aff'd in part and rev'd in part on other grounds, 103 S. Ct. 683 (1983); In re Catanella and E.F. Hutton & Company Inc. Securities Litigation, 583 F. Supp. 1388, 1415-1417 (E.D. Pa. 1984). In this action, the evidence establishes that plaintiff made

his investments at the worst possible time. In the decade preceding, oil and gas were "boom" investments and the price of oil was steadily increasing. In the early eighties, the trend reversed and the price of oil collapsed and has continued to the present time. By 1986, the oil industry was in a deep depression with oil down from $35 a barrel in 1980, to as low as $11 a barrel. The court is satisfied from the evidence plaintiff's monetary loss was the direct result of external market conditions and not the results of any mispresentations or omissions which may have been made. As indicated above, the time periods relative to plaintiff's investments were marked by an industry-wide collapse of oil and gas prices due to deregulation of the oil industry and a glut in oil supplies. Even the most sophisticated investors, such as major oil corporations, institutional lenders and banks, lost millions of dollars as a result

of the sudden increase in oil supplies and the unexpected drop in prices. Accordingly, plaintiff's claims of causation is broken. Simply put it is neither Hutton nor the sponsors' fault that plaintiff may have suffered loss as a result of the drop in prices. Huddleston, supra; In re Catanella, supra, 583 F. Supp. at 1416; Fryling v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 593 F.2d 736, 743-744 (6th Cir. 1979).

(2) Alleged Omissions.

Plaintiff contends that by virtue of certain alleged omissions Hutton is liable for a violation of Rule 10b-5.

In order to recover on his claim that there were omissions of material facts in the sale of the limited partnership interests, plaintiff must establish by a preponderance of the evidence for each of the investments, all of the following elements: (a) The defendant must make a false representation of a material fact, (b) knowing its falsity and

intending that plaintiff rely on it, (c) the plaintiff must justifiably rely on it, and (d) suffer damages as a result. _See_ 111 L. Loss, _Securities Regulation_ 1431; _Dupuy_ v. _Dupuy_ 551 F.2d 1005, 1014 (5th Cir. 1977), _cert. denied_, 434 U.S. 911, S.Ct. 312, 54 L.Ed.2d 197 (1977).

As discussed _supra_, plaintiff had knowledge of the alleged omissions of information prior to investing. The fact that plaintiff knew of these alleged defects but purchased anyway is fatal to his claim.

And, as previously noted, plaintiff has failed to prove that any alleged omissions were "material."

With regard to plaintiff's allegation that Hutton failed to disclose that the programs were "noneconomic," as discussed earlier in this opinion, I am not convinced by a preponderance of evidence that the programs at the time of sale were, in fact, non-economic.

More importantly, however, plaintiff has offered no proof that Hutton acted with scienter. Although plaintiff produced some evidence to support his claims the programs were "losers from the start", he has not persuaded me by a preponderance of evidence that that was so. In fact, the evidence shows that Hutton conducted state of the art due diligence studies with respect to each program in which plaintiff invested. During the course of his due diligence studies, Hutton found nothing which should have prevented it from selling the programs. Once wells are dug and millions of dollars spent with nothing to show but dry holes, it is not surprising that investors would claim the project was "non-economic". This is particularly true when the investor enters the market at the peak of oil prices and where they have then fallen steadily ever since.

For the foregoing reasons, plaintiff may not recover on his claim that Hutton violated Rule 10b-5 by virtue of omissions of material fact in the offering materials.

(3) <u>Alleged Fraud on the Market</u>.

Plaintiff further claims that Hutton committed a "fraud on the marked" in violation of Rule 10b-5. Plaintiff alleges that Hutton knowingly or recklessly sold "junk" and that the only reason the programs were marketable is because Hutton sold them.

There are four general elements to be proven by a purchaser asserting a fraud on the market theory of liability. First, the security must be "on the market" which means that it is available for purchase through some medium not requiring direct communication between the plaintiff and either the issuer of a prior holder. Second it must be unmarketable, meaning a security so lacking in basic essentials that, absent fraud, it would never have been issued or

marketed at any price. Third, the security must have reached the market as a result of the fraudulent scheme and as a result of the scheme to defraud plaintiff suffered a loss. Finally, reliance on the integrity of the market must be shown, i.e., a reliance that the securities would not be on the market unless entitled to marketed. See, Rose v. Arkansas Valley Environmental & Utility Authority, (CCH) Fed. Sec. L. Rep. paragraph 99, 224 (W.D. Mo., April 18, 1983) at pp. 95, 940-41, and cases cited therein, i.e., Shores v. Sklar, 647 F.2d 462 (5th Cir. 1981), (en banc), cert. denied, 459 U.S. 1102 103 S. Ct. 722 (1983); Dekro v. Stern Bros. & Co., 540 F. Supp 406 (W.D. Mo. 1982); Frankel v. Wyllie & Thornhill Inc, 537 F. Supp. 730 (W.D. Va. 1982).

The "market" upon which the plaintiff "relied" is not the type of market encompassed by the fraud on the market theory. Plaintiff did not purchase on an

open market, but in fact purchased through direct contact with the issuer via the prospectuses and the private placement memoranda. Accordingly, the fraud on the market theory is inopposite to the facts of this case.

Regardless, plaintiff has failed to prove that the litigated programs were "unmarketable," i.e., so lacking in basic essentials that absent fraud, they would never have been marketed at any price. Plaintiff's own expert, Osbourne, did not take the position that the programs were "lacking in basic essential" but only suggested that better investments might have existed at the time of plaintiff's investment. And, in contravention of plaintiff's proof, Mr. Holmes testified that looking forward from 1980 and 1981, in the climate of rising oil prices, the programs were indeed economic. For the foregoing reasons, plaintiff's "fraud on the market"

theory of liability under Rule 10b-5 must fail.

C. ALLEGED VIOLATION OF SECTION 11(a) OF THE SECURITIES ACT OF 1933.

Plaintiff alleges that Hutton violated Section 11(a) of the Securities Act, which provides in pertinent part:

> (a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue [to recover the damages specified in Section 11(e)]
>
> * * *

Section 11(a) Security Action of 1933, 15 U.S.C. Section 771(a).

Section 11 focuses entirely on the registration statement filed with the Securities and Exchange Commission; oral representations are not at issue under Section 11.

Not having offered into evidence the registration statements, plaintiff's Section 11 claims fail for lack of proof. Further, for the same reasons set forth above. Plaintiff's Section 11 claims are time barred by the limiting provision of Section 13.

And likewise for the reasons previously discussed, I am satisfied that plaintiff has not proven the materiality of any alleged written misrepresentations or omissions in the registration statement.

Finally, plaintiff had knowledge of the alleged omission and is thereby barred from recovery thereon.

Of greater significance, however, plaintiff has completely failed to offer essential proof on this claim. Plaintiff has not presented to the court copies of any registration statements from which the court could find violations of Section 11. Nor did plaintiff produce the testimony of any witness who had read the registration

statements, or who attested to their content. Plaintiff has the initial burden of showing the existence of the omission. He has not carried this burden.

Plaintiff produced at trial the prospectuses which are typically an attachment to the registration statements. Plaintiff requests the court to make the assumption that since a fact is not set forth in the prospectus, it is not set forth anywhere in the registration statement. Not having demonstrated to the court that the omission or misrepresentations actually exist, plaintiff can assert no claim for alleged omissions or misrepresentations in the registration statements.

Moreover, proofs establish that Hutton conducted due diligence investigations and had reasonable grounds to believe and did believe that the challenged portions of the registration statements were true and complete. Under Section 11, Hutton does not

have a duty to conduct due diligence. Having done so, however, and the results thereof having demonstrated that Hutton had no reason to forebear from offering the eleven programs, Hutton is absolved of any liability which might have attached due to errors in the registration statement of the sponsors.

D. ALLEGED VIOLATION OF SECTION 12(1) OF THE SECURITIES ACT OF 1933.

Plaintiff alleged in his Verified Second Amended Complaint that the sale to him of his interest in Indian Wells 1981-I, Ltd. constituted a violation of Section 12(1) of the Act. Section 12(1) makes actionable a violation of Section 5 of the Act which proscribes the sale of an unregistered security in a non-exempt transaction.

By Order and Opinion dated January 11, 1985, this court dismissed plaintiff's claim for any alleged violation of Section 12(1) as time barred by Section 13 of the Act which provides in pertinent part:

> No action shall be maintained to enforce any liability created . . . under [Section 12(1) unless brought within one year of the violation upon which it is based.

Security Act of 1933, Section 13, 15 U.S.C. Section 77m.

The court at the time held that any violation of Section 12(1) occurred in 1981 when Hutton allegedly failed to file a registration statement regarding the Indian Wells offering. See, Opinion p. 3. Since plaintiff did not file his complaint until June 23, 1983, he did not meet the one-year statutory period of Section 13.

Plaintiff at that time sought to avoid the effect of the statute of limitations by invoking the federal tolling doctrine based on fraudulent concealment. Under this doctrine, when a defendant fraudulently conceals its illegal conduct, the statute of limitations is tolled until the fraud is or should have been discovered. See, Opinion p. 4. This court held at that time that the

plaintiff could not invoke the doctrine for want of clear allegation of fraudulent concealment or fraud. See Id., citing Dyer v. Eastern Trust & Banking Co., 336 F. Supp. 890, 901 (D.Me. 1971).

At the pretrial conference of November 15, 1985, plaintiff was granted leave to amend his complaint to allege that Hutton fraudulently concealed from him that he was an unsuitable investor under Rule 146 (17 C.F.R. Section 240.146) and that the Indian Wells 1981-I program lost its exempt status under federal law. Plaintiff perceives that his unsuitability under Rule 146 would render the exemption claimed by Hutton pursuant to Rule 146 "lost" and would create a liability for a sale of an unregistered security in violation of Section 5 and Section 12(1)

In order to invoke the theory of fraudulent concealment, plaintiff must plead three elements with particularity:

(1) wrongful concealment of facts

giving rise to plaintiff's cause of action

(2) failure of the plaintiff to discover the operative facts that are the basis of his cause of action within the limitation period; and

(3) plaintiff's due diligence until the discovery of the facts.

Campbell v. Upjohn Co, 498 F. Supp. 722, 727 (W.D. Mich. 1980)

Since the doctrine of fraudulent concealment is in avoidance of the statute of limitations, the party seeking its benefit must prove each element. Id. Indeed all presumptions are against him since his claim in avoidance of the statute of limitations is "against the current of the law." Akron 496 F.2d 230, 233 (6th Cir. 1974), cert. denied, 419 U.S. 997, 95 S.Ct. 310, 426 L.Ed.2d 270 (1974). Cir.), cert. denied, 419 U.S. 997, 95 S. Ct. 310, 426 ed.2d 270 (1974).

From plaintiff's burden of proving the wrongful concealment of facts giving rise to his cause of action flows a fortiori his burden of proving the existence of the facts

allegedly concealed. It goes without saying that one cannot conceal that which does not in fact exist. Accordingly, to invoke the theory of fraudulent concealment, plaintiff must first prove that he was in fact unsuitable and that the Indian Wells offering did in fact lose its exempt status under federal law. This plaintiff has not done.

Hutton claims its exemption under federal law pursuant to the "safe harbor" Rule 146. The Rule 146 requirements as to the suitability of the investor are set forth below:

> (d) Nature of offerees. The issuer and any person acting on its behalf who offer, offer to sell, offer for sale or sell the securities shall have reasonable grounds to believe and shall believe:
>
> > (1) Immediately prior to making any offer, either:
> >
> > (i) That the offeree has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or

(ii) That the offeree is a person who is able to bear the economic risk of the investment; and

(2) Immediately prior to making any sale, after making reasonable inquiry, either:

(i) That the offeree has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment, or

(ii) That the offeree and his offeree representative(s) together have such knowledge and experience in financial and business matters that they are capable of evaluation the merits and risks of the prospective investment and that the offeree is able to bear the economic risk of the investment.

Rule 146 does not require an investor to be suitable. It only requires that the seller and issuer have reasonable grounds to believe and in fact believe that the investor was suitable. Two separate standards are set forth with Rule 146 relative to first, the offer, and second, the sale. Prior to making the offer the issuer and seller must reasonably believe, simply stated, (1) that

the investor is sophisticated or (2) that the investor can bear the risk of losing all his money. Before making the sale, the issuer and seller must reasonably believe, (1) that the offeree is sophisticated or (2) that the offeree and his representative together are sophisticated and that the investor can bear the risk of losing all his money.

Finally, Rule 146 does not have a specific income or net worth requirement per se. The specific income and net worth requirements discussed at length at trial are income and net worth requirements established under Michigan's Blue Sky Law and not Rule 146.

Plaintiff has not established that he was unsuitable to receive the offer or sale pursuant to Rule 146. Plaintiff has not shown that prior to receipt of the Indian Wells offering materials he was both unsophisticated and that he was unable to bear the economic risks of his prospective

investment. And, plaintiff has failed to prove that prior to the time of sale he was not sophisticated.

In fact, plaintiff concedes his "sophistication." He admits that he qualifies under NASAA guidelines, which also require both sophistication and wealth. While the "wealth" standards differ, the sophistication standards of the NASAA guidelines parallel the requirements of Rule 146 (and, for that matter, the Michigan Blue Sky law).

All proofs indicate that plaintiff was at all times relative to his complaint sophisticated enough to understand the merits and risk of his investment and in a position to bear the economic risks such that he could bear the loss of his investment. In light of the proofs, plaintiff has failed to demonstrate that he was in fact unsuitable.

Even if plaintiff was unsuitable, that would not establish that Hutton violated Rule

146. As already pointed out, plaintiff's suitability is not the issue in determining the existence of the Rule 146 exemption. The crucial issue under the Rule is not an investor's actual suitability, but the issuer and seller's reasonable grounds in believing that the plaintiff was suitable. Plaintiff has offered no evidence as to Hutton's or the sponsor's beliefs at the time of sale or the reasonableness of that belief. The only evidence in the cases that Hutton did reasonably believe that plaintiff was suitable. Finally, even if Hutton concealed from him the "fact" that it have violated Rule 146, such does not automatically cause the "loss" of exempt status under federal law. Rule 146 is a "safe harbor" provision under the general private offering exemption of Section 4(2) of the Act and non-exclusive, i.e., an issuer may still qualify for exemption under Section 4(2) even if in violation of Rule 146. Plaintiff has failed

to prove that Hutton did not comply with Section 4(2) and has therefore wholly failed to prove that the Indian Wells program lost its exempt status under federal law.

Accordingly, forth foregoing reason, plaintiff has failed to prove the existence of the very facts allegedly concealed from him. First, that he was unsuitable under Rule 146; secondly, that Hutton knew he was unsuitable and thirdly, that Indian Wells program lost its exempt status. There being nothing to conceal, plaintiff cannot now successfully invoke his theory of fraudulent concealment.

To the extent the evidence might suggest that plaintiff's suitability for Indian Wells was in doubt and that fact was concealed from him, plaintiff has wholly failed to meet his burden of proving that he did not know of the alleged facts concealed and that he exercised due diligence prior to the revelation of those facts. Plaintiff testified concerning

a telephone call from Mr. Potvin prior to his investment in Indian Wells in which Mr. Potvin informed him that the sponsor of Indian Wells had some doubt as to plaintiff's suitability. Plaintiff also recalled the mailing of a letter by him to the sponsor to satisfy the income requirements. There can be no doubt that this exchange would have and in fact did put plaintiff on notice of the fact that his suitability may have been in issue. At that point, plaintiff had a duty to investigate the suitability issue and failed to do so. As noted by Judge Gibson in Campbell v. Upjohn Co., supra, 498 F. Supp. at 728: "[I]f the plaintiff could have discovered his cause of action through due diligence, there is no need to grant him more time in which to act."

Further, plaintiff has failed to prove that the "facts" allegedly concealed were fraudulently concealed. The tolling concept is based on explicit, conscious deception,

concealment and bad faith on the part of a defendant. See Dyer v. Eastern Trust, supra, 336 F. Supp at 901. For a plaintiff to assert fraudulent concealment, he must prove "that the wrongdoer had contrived to deceive his victim . . . ." Dabney v. Levy, 191 F.2d 201, 204 (2d Cir. 1951) (L. Hand J.) cert. denied, 342 U.S. 887, 72 S. Ct. 177, 96 L. Ed. 665(1951). To prove fraudulent concealment plaintiff must identify affirmative acts of concealment continuing after the original wrong was complete. Campbell v. Upjohn Co., supra, 498 F.2d at 722. Plaintiff has not proven the existence of allegedly concealed facts, let alone Hutton's knowledge thereof. Accordingly, Hutton cannot be said to have fraudulently concealed facts from the plaintiff upon which his cause of action is based.

For the foregoing reasons, plaintiff has failed to prove that the one-year period of Section 13 should be tolled. Accordingly,

plaintiff's claim for an alleged Section 12(1) violation was and is time barred.

E. ALLEGED VIOLATION OF SECTION 410(a) OF THE MICHIGAN SECURITIES ACT, M.C.L.A. SECTION 451.810(a).

Plaintiff alleges further that the offer and sale to him of Indian Wells 1981-I constituted a violation of Section 410(a) (1) of the Michigan Uniform Securities Act, M.C.L.A. Section 451.810 (a) (1). This section of the Uniform Act makes actionable a violation of Section 301 of the Uniform Act, M.C.L.A. 451-701, which prohibits the sale of an unregistered security in a non-exempt transaction. However, Section 401(c) provides that "[a] person may not bring an action under this subsection (a) (1) more than two years after the contract of sale." M.C.L.A. Section 451.810 (e). No dispute exists that plaintiff purchased his interest in Indian Wells on February 2, 1981, and commenced this action on June 23, 1983, outside the two-year period. Accordingly,

absent a tolling, plaintiff's action under Section 410 (a) (1) is time barred.

Plaintiff argues in support of a tolling, that Hutton fraudulently concealed from him that he was unsuitable under Michigan law to receive the offer or the sale and, that as a result, the Indian Wells offering "lost" its exempt status under the Michigan Uniform Securities Act.

Tolling of the statute of limitation for fraudulent concealment is covered by M.C.L.A. Section 600.5855 which states in pertinent part:

> If a person who is or may be liable for any claim fraudulently conceals the existence of the claim ... from the knowledge of the person entitled to sue on the claim, the action may be commenced at any time within 2 years after the person who is entitled to bring the action discovers, or should have discovered, the existence of the claim ... although the action would otherwise be barred by the period of limitations.

M.C.L.A. Section 600.5855.

For essentially the same reasons previously discussed, plaintiff has failed to

prove his right to invoke the above tolling provision. As under the federal tolling provision, plaintiff bears the burden of proving the concealment. Dowse v. Gaynor, 155 Mich. 38, 118 N.W. 615 (1908). Once again it follows, that plaintiff must bear the burden of proving the existence of the facts allegedly concealed. In this instance, plaintiff argues that Hutton concealed from him his lack of suitability under Michigan law and that because of his unsuitability, Indian Wells "lost" its exemption. Plaintiff must, therefore, prove that he was in fact unsuitable and that the Indian Wells Offering lost its exempt status. This plaintiff has not done.

Hutton's exemption from registration arises under Section 402(b) (9) of the Uniform Securities Act. [M.C.L.A. Section 451.802(b) (9)]. Subsection (b) (9) (D) of Section 402 provides that in order to claim the Section 402(b) (9) exemption, the

offering must meet all the conditions of one of five separate sets of regulations. One of the separate "sets of regulations" is Section 402(b) (9) (D) (5) which exempts (if all other conditions of Section 402(9) (b) are met):

> (5) Sales made to a person who the seller has reasonable grounds to believe and does believe meets one of the following conditions:
>
> (i) A business entity having either (i) net income from operations after taxes in excess of $100,00.00 in its last fiscal year or its latest 12-month period, or (ii) a net worth in excess of $1,000,000.00 at the time of purchase, and after the purchase has less than 10% of its total assets invested in the securities of the issuer.
>
> (ii) An individual who after the purchase has an investment of more than $50,000.00 in the securities of the issuer, including installment payments to be made within 1 year after purchase by the investor; has either personal income before taxes in excess of $100,000.00 for his last fiscal year or latest 12-month period and is capable of bearing the economic risk, or net worth in excess of $100,000.00; and has such knowledge and experience in financial and business matters that he is capable of evaluating the merits and risks of the prospective investment or has obtained the advice of an attorney,

> certified public accountant, or investment advisor registered under the investment advisers act of 1940, or an investment adviser registered under this act, with respect to the merits and risks of the prospective investment.

Summarized, Section 5(ii) exempts sales to individuals whom the seller reasonably believes:

> 1) has after the sale more than $50,000 invested in the issuer;
>
> 2) has either (a) personal income before taxes of greater than $100,00 in the last fiscal year or latest 12-month period and is capable of bearing the economic risk, or (b) has a net worth in excess of $1,000,000; and
>
> 3) is sophisticated or has adequate investment advice from a sophisticated advisor.

Subsection 5(ii) does not set forth a suitability requirement for the receipt of offers but only for sales. Furthermore, the income requirement requires that the $100,000 income be realized in either the last fiscal year or latest 12-month period. The Indian Wells offering memorandum sets forth a sponsor requirement of income greater than $100,000 in the prior fiscal year and there

is no mention that the income requirement can be met if $100,000 is received during the prior 12-month period. Indian Wells is free to set higher standards for itself but is bound only to the law. The issue of plaintiff's suitability under M.C.L.A. Section 451.802 must be determined by reference to the statute as opposed to the Indian Wells offering memorandum itself.

Plaintiff apparently alleges that he did not meet the requirements as set forth by Section 5(ii) and that as a result, Hutton lost its exemption. Plaintiff has not met his burden of proving that he was unsophisticated or unable to bear the economic burden of his investment. In fact, he concedes his sophistication to the contrary under the NASAA guidelines which parallel Section 5(ii). Plaintiff's main focus is, of course, on the income requirements of the statute. Plaintiff alleges that he did not meet the requirements

of making $100,000 in the "last fiscal year", i.e., 1980. However, as earlier pointed out this statement flies in the face of his letter to Indian Wells specifically stating his income in 1980 exceeded $100,000. However, the income requirement may also be satisfied upon receipt of income in excess of $100,000 in the "past 12 months" prior to the sale. Plaintiff has testified that he received a payment of over $230,000 from his professional corporation in January of 1981, i.e., within 30 days of his investment. As a result, plaintiff has proven his own suitability under Michigan law thereby mooting the concealment issue.

Furthermore, plaintiff has failed to meet his burden of proving that by virtue of his "unsuitability," the Indian Wells offering lost its exempt status under the Michigan Uniform Securities Act. Again, the issue is not an investor's suitability, but the issuer's and seller's reasonable grounds

to believe that the plaintiff was suitable. Plaintiff has offered no evidence as to Hutton's or the sponsor's beliefs at the time of sale or the reasonableness of that belief. Absent proof that Hutton did not reasonably believe that plaintiff was suitable at the time of sale, plaintiff cannot now challenge the exempt status of the offering.

Finally, even if plaintiff is unsuitable pursuant to Section 402(b) (9) (D) (5) (ii), there are four other subsections under Section 402(b) (9) (D) under which the offering could be deemed exempt. In other words, to prove that the offering lost its exempt status, plaintiff would have to prove that Hutton and the sponsors did not comply with any of the provisions under Section 402(b) (9) (D). This plaintiff has not done.

Accordingly, for the foregoing reasons, plaintiff has failed to prove the existence of the very facts allegedly concealed from him, namely that he was unsuitable, that

Hutton knew he was unsuitable, and that Indian Wells program lost its exempt status. There being nothing to conceal, plaintiff cannot now successfully invoke his theory of fraudulent concealment.

Additionally, plaintiff has failed to prove that the "facts" allegedly concealed were fraudulently concealed. In the context of M.C.L.A. Section 600.5885, fraudulent concealment means the employment of an artifice, planned to prevent inquiry or escape investigation and to mislead or hinder the acquirement of information regarding a cause of action. Grebner v. Runyon, 132 Mich App. 327, 347 N.W.2d 741 (1984).

For the foregoing reasons, plaintiff has failed to prove a claim under Section 410(a) of the Michigan Securities Act.

F. ALLEGED FRAUD AND ALLEGED VIOLATION OF THE MICHIGAN CONSUMER PROTECTION ACT.

Under Michigan Law, the standard of proof in proving fraud appears to be somewhat

murky. See dissent in Disner v. Westinghouse Corp. 726 F.2d 1106 (6th Cir. 1984). Regardless of whether the standard is by "fair preponderance of evidence" or as the majority in Disner asserts by "clear and convincing evidence", I am satisfied plaintiff has failed to prove his claim under either test. The general rule is that to constitute actionable fraud, it must appear: (1) that defendant made a material representation; (2) that it was false; (3) that when he made it he knew it was false, or made it recklessly, without any knowledge of its truth, and as a positive assertion; (4) that he made it with the intention that it should be acted upon by plaintiff; (5) that plaintiff acted in reliance upon it; and (6) that plaintiff suffered injury. Candler v. Heigho, 208 Mich. 115, 175 N.W.141 (1919). Fassihi v. Sommers, Schwartz, Silver, Schwartz & Tyler, P.C., 107 Mich. App. 509,

309 N.W.2d 645 (1981); Gorman v. Soble, 120 Mich App. 831, 328 N.W.2d 119, (1982).

For the reasons previously stated, with respect to alleged Rule 10b-5 violation, the court is satisfied that plaintiff has not borne his burden of proving by clear and convincing evidence or by a preponderance of the evidence that material misrepresentations were made; that Hutton or Mr. Potvin acted knowingly or recklessly with regard to any material misrepresentation that may have been made; that plaintiff justifiably relied on any misrepresentation that may have been made; and that any loss suffered by plaintiff was as a proximate result of any misrepresentation that may have been made. Accordingly, plaintiff cannot recover for common law fraud.

The second sub-allegation of Count III is a claim for a violation of the Michigan Consumer Protection Act, Section 3(y), (bb) and (cc).

This act was instituted to punish unfair, unconscionable or deceptive methods, acts or practices in the conduct of trade or commerce. The sections relied upon by plaintiff for his cause of action define such practices to include:

> (y) Gross discrepancies between the oral representations of the seller and the written agreement covering the same transaction or failure of the other party to the transaction to provide the promised benefits.
>
> (bb) Making a representation of fact or statement of fact material to the transaction such that a person reasonably believes the represented or suggested state of affairs to be other than it actually is.
>
> (cc) Failing to reveal facts which are material to the transaction in light of representations of fact made in a positive manner.

With respect to Subsection (y), plaintiff has not proved the existence of oral representations of fact or that such representations if made were grossly inconsistent with the written agreements covering the investments. Finally, plaintiff has failed to prove that he was "promised"

anything and the offering memoranda certainly cannot be construed "to promise" results in a positive manner.

With respect to Subsection (bb), plaintiff has failed to prove misrepresentation of fact material to the transaction, or that any such misrepresentation was reasonably relied on. Plaintiff could not have reasonably believed any allegedly rosy predictions in the face of repeated warnings of "high risk" as contained in the offering documents.

And with regard to Subsection (cc) no omission of material facts have been proven.

For the foregoing reasons, plaintiff has failed to prove the requisite elements of a violation of the Michigan Consumer Protection Act.

G. ALLEGED BREACH OF FIDUCIARY DUTY.

The essence of Counts IV and VI, is an allegation of breach of a fiduciary duty owing to the plaintiff. In order to prove

that Hutton is liable for this alleged misconduct and breach of fiduciary duty, plaintiff must show: that Hutton, through its broker, Joseph Potvin, had a duty to the plaintiff; that Hutton breached its duty; and that plaintiff was injured as a proximate result thereof.

Upon the evidence presented, I have serious doubt that a fiduciary duty was owed by Hutton to plaintiff. Plaintiff was at all times pertinent to this inquiry and by all accounts and proofs an intelligent, inquisitive, and self-reliant man, inherently disinclined to relinquish his trust to anyone. Plaintiff independently investigated the oil and gas business prior to making his investments. Plaintiff reviewed and rejected numerous offerings made by Hutton. Decisions on investments were made by plaintiff, on his own, after careful review of the sponsors' materials. He repeatedly ignored Hutton's recommendations to seek additional financial

advice. He continually sought additional data from Hutton of a highly technical nature. To now claim he blindly placed his trust in Hutton is contrary to the sworn testimony.

Assuming that plaintiff did in fact repose his trust in Hutton, as a non-discretionary broker, Hutton would have the following recognized duties:

1. to recommend a security only after studying it sufficiently to become informed as to its nature, price and structure;

2. to carry out the customer's orders promptly in a manner best suited to serve the customer's interests as embodied in the customer's instructions;

3. to inform the customer of the risks involved in purchasing or selling a particular security;

4. to refrain from self-dealing or refusing to disclose any personal interest the broker may have in a particular recommended security;

5. to not misrepresent any fact material to the transaction; and

6. to transact business only after receiving prior authorization from the customer.

Leib v. Merrill Lynch, Pierce, Fenner & Smith Inc., 461 F. Supp 951 (E.D. Mich 1978).

Plaintiff has failed to carry his burden of proving that Hutton violated any fiduciary duty that may have been owed to plaintiff. The manner in which the broker is to perform these duties will depend to some degree upon the intelligence and personality of his customer. If the customer is uneducated or generally unsophisticated with regard to financial matters or incapable of understanding the transaction, the broker must define the particulars of the transaction more carefully and cautiously. However, if the customer fully understands the dynamics of the market or is personally familiar with the security or insists on making his own decisions despite information, such as plaintiff, the broker's explanation of the risks may be merely perfunctory. Leib v. Merrill Lynch, Pierce, Fenner & Smith,

Inc., supra, is an important and controlling case in this area.

In this action, plaintiff is an attorney and became knowledgeable in oil and gas investments during the time he made his investments. He received all offering materials prior to investment and he made his own investment decisions. On their part, Hutton and Mr. Potvin adequately investigated and became familiar with the nature of plaintiff's financial circumstances prior to plaintiff's investment. Hutton at all times followed plaintiff's instructions and otherwise met its responsibilities. The only evidence which plaintiff presented in support of his claim of breach of fiduciary duty was that Eric Dawe, his current account executive, who concluded that the eleven oil and gas investments were not suitable for plaintiff based on a reading of the complaint. Mr. Dawe never examined plaintiff's tax return. I have reviewed

carefully Mr. Dawe's testimony and weighed it against other evidence in the case. Plaintiff has failed to prove by a preponderance of the evidence that defendant breached any fiduciary duty owed to plaintiff. In any event, in a non-discretionary account the customer may not complain if he knowingly selects an investment. Stated simply, plaintiff has not proven that Hutton violated the fiduciary duty of a non-discretionary broker.

H. ALLEGED BREACH OF CONTRACT

Plaintiff in Count V of his complaint alleges that Hutton breached a contract with him. In order to recover on this theory, plaintiff must prove (1) that a contract existed between the parties, (2) the terms of the contract, (3) that Hutton breached the contract, and (4) that the breach caused his injury.

Plaintiff alleges that Hutton agreed to provide investment advice and corresponding

investments that would defer tax liability. Even if a contract existed between the parties and I have some doubt about this, plaintiff has not met his additional burden of proving that Hutton in fact breached the terms thereof. Unquestionably, Hutton provided investment advice and investments that in fact provided the tax write-offs plaintiff sought.

I. ALLEGED VIOLATION OF THE RACKETEER INFLUENCED AND CORRUPT ORGANIZATION ACT (RICO) 18 U.S.C. SUBSECTION 1961, ET SEQ.

In Count VI, plaintiff alleges that defendant Hutton violated 18 U.S.C. Subsections 1961-1968, the Racketeer Influenced and Corrupt Organizations Act (RICO).

The act states in part that:

> It shall be unlawful for any person who (1) through the commission of two or more acts (2) constituting a "pattern" (3) of "racketeering activity" (4) directly or indirectly invests in, or maintains and interest in, or participates in (5) an "enterprise" (6) the activities of which affect interstate or foreign commerce.

18 U.S.C. Subsections 1962(a) - (c) (1976)

The core violation of federal RICO is the acquisition or maintenance of ownership or control of, or conduct of or participation in, and enterprise in or affecting interstate commerce, if accomplished through a "pattern or racketeering activity.

The "pattern of racketeering activity" which plaintiff Platsis alleges that defendant Hutton was engaged in include:

- fraud. 18 U.S.C. 1961 (D)
- use of U.S. mail and facilities in interstate commerce for mail fraud. 18 U.S.C. 1961(1) (B)
- fraud in the sale of securities. 18 U.S.C. 1961(D).

In order to recover under RICO, plaintiff must prove by a preponderance of the evidence that Hutton through the commission of two or more acts constituting a "pattern" of "racketeering activity" directly or indirectly invested in, maintained an interest in, or participated in an "enterprise" the activities of which affect

interstate commerce. Sedima, S.P.L.R. v. Imrex, Col, Inc., ___ U.S. ___, 105 S.Ct. 3275, 3285, 87 L.Ed. 2d 346, 358-59 (1985).

Plaintiff has the burden of proving by a preponderance of the evidence that the allegedly fraudulent predicate acts were at least two in number and related to an overall enterprise of defrauding him in connection with the claims asserted in this lawsuit. Sedima v. Imrex, supra, 105 S.Ct. at 3282, 3286; Farmers Bank of Delaware v. Bell Mortgage Corp., 452 F. Supp. 1278, 1281 (D. Del. 1978).

Plaintiff must also establish a pattern of racketeering activities, i.e., a series of "predicate acts" which are sufficiently related to the current complaint as to be described as similar acts. Sedima v. Imrex, supra, 105 S.Ct. at 3285 n.14. Absent proof of a "relationship" or "continuity" between the alleged predicate acts and the acts alleged in the instant complaint, a plaintiff

lacks standing to complain under RICO. Conan Properties, Inc. v. Mattel, Inc., 519 F. Supp. 1167 (S.D.N.Y. 1985); Northern Trust Bank/O'Hare N.A. v. Inryco, Inc., 615 F. Supp. 828 (N.D. Ill. 1985).

Plaintiff must also establish that Hutton, as the entity comprising the "enterprise," is distinct and unaffiliated from Hutton as a RICO defendant. Rae v. Union Bank, 725 F.2d 478, 481 (9th Cir. 1984); Nunes v. Merrill Lynch, Pierce, Fenner and Smith, Inc., 609 F. Supp. 1055, 1064 (D. Md. 1985); Lopez v. Dean Witter Reynolds, 591 F. Supp. 581 (N.D. Cal. 1984).

Plaintiff must also establish that defendant directly or indirectly invested in or maintained an interest in or participated in the conduct of the enterprises about which he complains. In this case plaintiff must prove that defendant and the various oil and gas companies operated as a unit. Since Hutton and the sponsors are distinct

entities, this element cannot be satisfied. The enterprise must have a distinct structure separate from the pattern of racketeering.- U.S. V. Bledsoe, 674 F.2d 647 (8th Cir. 1982).

Plaintiff in this action has failed to prove fraudulent or predicate acts on the part of Hutton. Further, plaintiff has failed to prove that any fraudulent or predicate acts on the part of Hutton were related to an overall scheme to defraud the plaintiff. Likewise plaintiff has failed to prove any fraudulent or predicate acts were sufficiently related to the complaint so as to be described as "security violation." Further, no evidence establishes that Hutton invested or participated in an "enterprise." Accordingly, plaintiff cannot recover for an alleged violation of RICO.

CONCLUSION

For all the reasons discussed above, a judgement of no cause for action is entered in favor of defendant and against plaintiff.

Douglas W. Hillman
Chief Judge

Dated: August 4, 1986

~~Brief~~ in Opposition to Certiorari

Supreme Court, U.S.
FILED
MAR 3 1988
JOSEPH F. SPANIOL, JR.
CLERK

No. 87-1258 (2)

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1987

GEORGE J. PLATSIS, Petitioner

v.

E.F. HUTTON & COMPANY INC., Respondent

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

RESPONDENT'S BRIEF IN OPPOSITION

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Questions Presented

Petitioner George Platsis, an attorney acting pro se, brought an action in state court which was removed to the United States District Court for the Western District of Michigan. In his Complaint, as amended, Petitioner asserted, inter alia, a cause of action based on alleged violations of Section 10(b) of the Securities Exchange Act of 1934 ("Section 10(b)"), 15 U.S.C. §78j(b) and Securities and Exchange Commission Rule 10b-5 ("Rule 10b-5") promulgated thereunder. The alleged securities fraud was said to have arisen in connection with Petitioner's purchase of eleven interests in various oil and gas tax shelter limited partnerships ten of which Petitioner purchased through the Respondent brokerage house, E.F. Hutton & Company Inc. ("Hutton").

In order to state a cause of action under Section 10(b) and Rule 10b-5, a plaintiff must establish each of the following with respect to a security: that the defendant made a misrepresentation of a material fact or omitted to state a material fact which omission rendered an affirmative representation misleading; that plaintiff justifiably relied on the misrepresentation or omission of material fact; that the defendant acted with scienter in making the misrepresentation or omission of material fact; and that plaintiff suffered damages as a direct and proximate result of the misrepresentation or omission of material fact. Following a lengthy trial, the Honorable Douglas W. Hillman, Chief Judge, presiding, concluded that Petitioner had failed to meet his burden of proof with respect to materiality, reliance and scienter. Moreover, the District Court

affirmatively found that the alleged misrepresentations and omissions, if any, were not the direct and proximate cause of Petitioner's losses. The Court of Appeals for the Sixth Circuit affirmed the District Court's opinion.

The questions before this Court as presented by Petitioner appear to be whether, as a matter of law:

1. Petitioner was required to prove reasonable reliance upon alleged misrepresentations and omissions of material fact in order to recover under Rule 10b-5, including fraud-on-the-market.

2. The District Court and the Court of Appeals erred in applying the standard for reasonable or justified reliance set forth in Kennedy v. Josephthal & Co., 635 F. Supp. 399 (D. Mass. 1985), aff'd, 814 F.2d 789 (1st Cir. 1987), with regard to Petitioner's Rule 10b-5 claim.

3. The District Court erred in finding that:

(a) Information concerning the past performance of prior unrelated limited partnerships and "speculative projections" of the limited partnerships purchased by Petitioner was not material;

(b) The nondisclosure of information to investors concerning estimated oil and gas reserves and the present value of such estimated reserves, where such information is specifically exempted from disclosure to investors by Securities Exchange Commission accounting regulations, was not material and properly omitted from the offering memoranda;

(c) The oil and gas limited partnerships in question were

economically viable when offered to Petitioner;

(d) Petitioner's damages resulted from the precipitous decline in oil and gas prices and not as a result of alleged misrepresentations and omissions on the part of Respondent or the sponsors of the underlying investments.

Respondent contends that the threshold question before this Court is whether a writ of certiorari should be granted herein. Repondent believes that resolution of Petitioner's questions would not be dispositive of the case, that no important questions of federal law are presented and that there are no conflicts which need resolution. For the reasons asserted below, Respondent submits that Petitioner's Petition for an Order Granting a Writ of Certiorari should not be granted.

LIST OF PARTIES

The parties to the proceedings below were the Petitioner George J. Platsis and the Respondent E.F. Hutton & Company Inc.

At all times during the pendency of the trial and initial appeal E.F. Hutton & Company Inc. was a wholly owned subsidiary of The E.F. Hutton Group Inc. E.F. Hutton & Company Inc. has since been acquired and merged into Shearson Lehman Hutton Inc.

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No. 87-1258

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1987

GEORGE J. PLATSIS, Petitioner

v.

E.F. HUTTON & COMPANY, INC., Respondent

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

Respondent E.F. Hutton & Company Inc. respectfully requests this Court to deny the petition for writ of certiorari seeking review of the opinion of the Court of Appeals for the Sixth Circuit reported at 814 F.2d 798.

STATEMENT OF THE CASE

Petitioner is a well educated and intelligent attorney who has worked as a trial attorney for the Federal Trade Commission, the Michigan Department of Attorney General, Consumer Protection Division, and the Michigan Department of Transportation. Petitioner is currently in private practice, specializing in personal injury and medical malpractice litigation. Petitioner continues to assist in the defense of highway negligence and condemnation actions as a Special Assistant Attorney General for the State of Michigan.

As a result of several years' efforts in connection with the representation of a personal injury plaintiff, Petitioner received a contingent fee in the approximate amount of $500,000.00 in 1980. To reduce what he considered an "unfair" tax burden falling in one year, Petitioner

sought tax shelter investment advice from Hutton's Lansing, Michigan office.

From 1980 through 1982, Petitioner invested in eleven oil and gas limited partnerships. Hutton was the sales agent with respect to ten of Petitioner's tax shelter investments.

In response to disappointing returns on his oil and gas investments, Petitioner brought suit in Michigan state court which action was removed to the United States District Court for the Western District of Michigan. Petitioner sued Hutton for alleged misrepresentations and omissions made to Petitioner by Hutton and Hutton's account executive Joseph Potvin, in alleged violation of the federal securities laws, including Rule 10b-5, the Racketeer Influenced and Corrupt Organizations Act, various state laws and the common law.

The District Court, in an extensive opinion by Chief Judge Hillman, found that Petitioner had failed to satisfy his burden of proof with respect to each and every element of each cause of action.

On appeal, the Court of Appeals for the Sixth Circuit affirmed the judgment of the District Court and specifically found that "[t]he district court opinion addresses each of plaintiff's claims and makes findings as to each from which he concluded that plaintiff has failed to carry his burden of proof." (Pet. 4a)

REASONS WHY THE PETITION SHOULD BE DENIED

The Questions Presented in the Petition are not dispositive of the action below and do not raise important questions of federal law. Indeed, the Questions Presented raise issues of fact, not law, and raise issues not raised or addressed by

the courts below in the manner asserted by Petitioner. Moreover, the decisions of the lower courts are not in conflict with decisions of this Court and there is no conflict among the Circuit Courts of Appeals.

I. THE QUESTIONS PRESENTED ARE NOT DISPOSITIVE OF ACTION BELOW

This Court's articulated standards for granting a writ of certiorari require that a conflict exist either between this Court and a Court of Appeals, or as between Courts of Appeals, and that resolution of the conflict will be dispositive of the action below. The mere allegation of a conflict is not in and of itself a sufficient basis for granting a writ of certiorari. "While this court decides questions of public importance, it decides them in the context of meaningful litigation. Its function in resolving conflicts . . .

is judicial, not simply administrative or managerial." The Monrosa v. Carbon Black Export, Inc., 359 U.S. 180, 184 (1959). It is not a proper exercise of this Court's discretionary jurisdiction to pass upon a conflict when to do so would have no impact on the ultimate outcome of the case below. See, e.g. Monrosa, supra.

Petitioner is asking this Court to determine whether he was required to prove reasonable or justified reliance upon the alleged misrepresentations and omissions in the context of a Rule 10b-5 action. Since the lower courts found that Petitioner had failed to prove each and every other element necessary to state a cause of action under Rule 10b-5 the determination sought by Petitioner before this Court would not change the ultimate outcome reached below.

Thus, a grant of a writ of certiorari is inappropriate. See Monrosa, supra.

II. THE QUESTIONS PRESENTED DO NOT RAISE IMPORTANT QUESTIONS OF FEDERAL LAW

a. The Petition Primarily Presents Questions of Fact.

This Court has traditionally refused to review the factual findings of a District Court which have received the affirmance of the appropriate Court of Appeals. See, e.g. Berenyi v. District Director, Immigration and Naturalization Service, 385 U.S. 630, 635 (1967) ("[this Court] 'cannot undertake to review concurrent findings of fact by two courts below in the absence of a very obvious and exceptional showing of error.'")

A cursory review of the Petition and Questions Presented herein shows that the Questions Presented regarding "reasonable reliance" and "materiality" raise, at best,

mixed questions of law and fact involving statutory standards which have meaning only in their application to the particular facts of this case. _See_, _TSC Industries, Inc. v. Northway, Inc._, 426 U.S. 438, 450-451 (1976). As has been recognized, this Court "is not the place to review a conflict of evidence . . . [this rule has] special applicability to cases where, as here, a statutory standard . . . can have meaning only in its application to the particular facts of a particular case." _NLRB v. American Nat. Ins. Co._, 343 U.S. 395, 410 (1952).

Accordingly, a grant of a writ of certiorari is clearly inappropriate and unwarranted in this case.

b. The Petition Raises Issues Not Raised or Addressed by the Courts Below in the Manner Asserted by Petitioner.

A writ of certiorari is not appropriate to address a question or issue which

was "not properly raised, litigated or passed upon below." McCullough v. Kammerer Corp., 323 U.S. 327, 328 (1945).

Petitioner asserts that the lower courts' determination that he unjustifiably relied upon the alleged misrepresentations and omissions of Hutton was based upon Kennedy v. Josephthal & Co. Inc., 814 F.2d 798 (1st Cir. 1987) (Pet. 21). To the extent the District Court found the proofs lacking on the issue of justifiable reliance, it did so on the authority of Zobrist v. Coal-X, Inc., 708 F.2d 1511 (10th Cir. 1983), cited in Platsis v. Hutton (Pet. 72a). Indeed, the appellate decision in Kennedy v. Josephthal had not been rendered when the District Court made its findings. To the extent the Platsis Court of Appeals relied on the appellate decision in Kennedy v. Josephthal, it appears to be

for the purpose of determining the proper method for calculating the statutes of limitations.

More particularly, the _Platsis_ District Court relied on the _Kennedy v. Josephthal_ lower court opinion only in the context of Petitioner's claim asserted pursuant to Section 12(2) of the Securities Act of 1933. Based on _Kennedy v. Josephthal_, the District Court found that Petitioner was put on inquiry notice of the alleged fraud more than one year prior to the filing of his action, and, as a result, his Section 12(2) cause of action was time barred. The _Platsis_ trial court's opinion makes no reference to _Kennedy v. Josephthal_ in arriving at its opinion that Petitioner failed to prove justifiable reliance under Rule 10b-5.

The Court of Appeals for the Sixth Circuit affirmed the trial court's Findings

of Fact noting that Kennedy v. Josephthal, relied upon by the District Court, had since been affirmed. It appears that the Court of Appeals' reference to Kennedy v. Josephthal was merely to reaffirm its importance in the context in which it was originally invoked by the District Court.

Petitioner is asking this Court to reexamine the lower courts' application of the standard for proving justifiable reliance under Rule 10b-5 as set forth in Kennedy v. Josephthal when the lower courts did not refer to Kennedy v. Josephthal in connection with the reliance issue. Petitioner cannot assume that the Court of Appeals intended to adopt a broader application of Kennedy v. Josephthal than its application by the District Court.

A writ of certiorari is not proper in this instance where the issue raised was

neither discussed nor litigated before the District Court or the Court of Appeals.

III. NO CONFLICT EXISTS WHICH SUPPORTS A GRANT OF A WRIT OF CERTIORARI

Petitioner asserts that the conclusion reached by the lower courts that Petitioner was required to prove he reasonably or justifiably relied upon the alleged misrepresentations and omissions of Hutton conflicts with this Court's decisions in Bateman Eichler, Hill Richards, Inc. v. Berner, 105 S. Ct. 2622, 472 U.S. 299 (1985); Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976); and Affiliated Ute Citizens v. United States, 406 U.S. 128, 153, 154 (1972). Petitioner also asserts a conflict between the lower courts' opinions in Platsis v. Hutton and Shores v. Sklar, 647 F.2d 462 (5th Cir. 1981), cert. denied. 459 U.S. 1102 (1983). There are no conflicts.

a. Affiliated Ute Citizens v. United States

In Affiliated Ute this Court held that in a case involving primarily a failure to disclose material information (material omissions) a plaintiff asserting a Rule 10b-5 cause of action need not offer positive proof of reliance but that reliance may be presumed. Affiliated Ute, 406 U.S. at 153; Shores, supra, 647 F.2d 468. Affiliated Ute does not, however, eliminate reliance as an element of a plaintiff's claim. Id.

Here, unlike Affiliated Ute, Petitioner's complaint alleged both misrepresentations and omissions and therefore the Affiliated Ute "presumption" of reliance is inapplicable. See, e.g. Cavalier Carpets, Inc. v. Caylor, 746 F.2d 749 (11th Cir. 1984); Wilson v. Comtech Telecommunications Corp., 648 F.2d 88 (2d Cir. 1981); and

Vervaecke v. Chiles, Hieder & Co., Inc., 578 F.2d 713 (8th Cir. 1978). Moreover, the presumption, if available, is rebuttable--a defendant can show, _inter alia_, that the plaintiff did not rely on the defendant's duty to disclose. _See_, _e.g._, _Shores_, _supra_, 647 F.2d at 468. As Chief Judge Hillman found, Petitioner _knew_ of the omitted information but invested anyway. (Pet. 76a). Hence, he did not rely on Hutton's duty to disclose or on the availability of the omitted information. To the extent reliance may have been properly presumed, Petitioner's trial testimony rebutted that presumption. Clearly, the Court of Appeals' decision affirming the District Court is not in conflict with _Affiliated Ute_.

b. Ernst & Ernst v. Hochfelder

Petitioner's assertion that the decision of the Court of Appeals conflicts with Hochfelder, supra, is without merit. Petitioner does not refer to or discuss the Hochfelder decision except for the initial reference to the case in the Petition on page 23.

c. Bateman Eichler, Hill Richards, Inc. v. Berner

Petitioner contends that this Court's decision in Berner, supra, held that common law defenses are inappropriate in securities actions. Petitioner misinterprets this Court's statements in Berner. In Berner this Court held only that common law defenses may be inappropriate in actions arising under the securities laws where their application would "significantly interfere with the effective enforcement of the securities

laws and protection of the investment public;" <u>Berner</u>, 105 S. Ct. at 2629. To the extent the District Court applied common law defenses, this application is wholly consistent with <u>Berner</u>.

d. <u>Shores v. Sklar</u>

Having found that Petitioner's tax shelters were purchased by way of "face-to-face" transactions the District Court held that the fraud-on-the-market theory of recovery was inapplicable to the type of market in which Petitioner had purchased his limited partnership interests. Petitioner claims this was error.

In effect, Petitioner is asserting a conflict between the District Court's Findings and the holding of the Court of Appeals for the Fifth Circuit in <u>Shores v. Sklar</u>, <u>supra</u>. In <u>Shores</u>, the Court of Appeals held, <u>inter alia</u>, that in order to

recover under a fraud-on-the-market theory for newly issued securities, Petitioner must establish that the securities would not have been marketable but for the fraud. Id., 647 F.2d at 469-70. The District Court specifically found that Petitioner failed to prove that the securities litigated herein were unmarketable. (Pet. 80a-81a) Petitioner's lengthy discourse as to how the District Court erred in finding that the limited partnership interests were economically viable relates only to the correctness of the Findings of Fact reached by the District Court rather than a conflict with Shores.

CONCLUSION

For the reasons stated above, the Petition for a Writ of Certiorari should be denied.

Dated: March 1, 1988

Respectfully submitted,

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No. 87-1258

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1987

GEORGE J. PLATSIS,

Petitioner,

v.

E.F. HUTTON & COMPANY, INC.,

Respondent.

PETITIONER'S REPLY BRIEF

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Petitioner's Reply Brief

No. 87-1258

IN THE SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1987

GEORGE J. PLATSIS, Petitioner

V.

E.F. HUTTON & COMPANY, INC., Respondent

Respondent makes several assertions in opposition to the Petition for a Writ of Certiorari, only one of which requires a response, i.e., that the questions presented will not dispose of the case in Petitioner's favor.

The Trial Court made findings of fact from which certain erroneous conclusions of fact and law were drawn. The Court of Appeals

affirmed, without making any additional findings of fact or law, relying heavily upon Kennedy v. Josephthal & Co., 814 F2d 798 (1st Cir., 1987). Therefore, it was incumbent upon Petitioner to discuss the inapplicability of that case while at the same time demonstrating that the Trial Court's opinion conflicts with legal doctrines of this Court. Further, Petitioner asserts that the recognized fraud-on-the-market theory of recovery should be extended from open market transactions to "new issue" sales controlled by underwriters such as Hutton, which in reality is a market maker.

Allowing the lower courts' decisions to stand, without modification and partial reversal as to their finding of no liability under Rule 10b-5, would 1) allow manifestly erroneous conclusions of law to become inappropriate if not dangerous precedent, 2)

discourage private enforcement of securities law, <u>Perma Life Mufflers</u> v. <u>International Parts Corp.</u>, 392 U.S. 134, 136 (1968), and 3) undermine decisions of this Court which have been responsible for restoring investor confidence.

Contrary to Respondent's assertion, Petitioner seeks reversal of the Trial Court's legal conclusions set forth in appendix pages 51a-67a and 75a-81a. If its legal analysis is incorrect, and Petitioner is entitled to relief, this case must be remanded for a determination of damages under the Exchange Act of 1934.

All the necessary elements to prove that Petitioner is entitled to monetary relief under Rule 10b-5 are set forth in his Petition.

To recover under Rule 10b-5(a) and (c) a preponderance of the evidence must establish

the following elements: 1) that the omissions were material, Affiliated Ute Citizens v. United States, 405 U.S. 128 (1972); 2) that Hutton had a duty to disclose known material facts, i.e., a duty of honesty and fair dealing, Bateman-Eickler, Hill Richards, Inc. v. Berner, 472 U.S. 299, 313 (1985); 3) that Hutton acted with something more than mere negligence, Ernst & Ernst v. Hockfelder, 425 U.S. 185 (1976); 4) that Petitioner detrimentally relied upon the acts, practices and omissions of Hutton, Affiliated Ute, and in the context of this case, 5) that state of the art projections, utilized in the oil and gas business for years, are material "facts". Eisenberg v. Gagnon, 766 F2d 770, 775 (3rd Cir., 1985). [There is no question that the programs are securities sold by the use of the requisite jurisdictional means (68a).]

Such essential proofs may be established

by direct admissions of the defendant or inferred from circumstantial evidence, findings of fact, or findings of law.

A duty to disclose material facts is self evident from the Trial Court's finding that "unquestionably" Petitioner received investment advice from Hutton (114a) and Hutton's duty of honesty and fair dealing. Berner.

Direct proof of detrimental reliance is also not required. Affiliated Ute.

Direct proof of "scienter" is not required because something more than negligence may be inferred from repeated sales of demonstrably worthless securities. Indeed, knowledge with intent to defraud can be inferred where an issue is "so lacking in basic requirements that ... had any one of the participants in the scheme not acted with intent to defraud or in reckless disregard of"

whether others were perpetrating a fraud, the issue would never have been marketed. Shores v. Sklar, 647 F2d 462, 468 (5th Cir., 1981).

Finding that an issue is unmarketable is tantamount to establishing scienter in its sale.

During its motion for directed verdict, defense counsel argued "Plaintiff is a sophisticated ... capable ... well educated person capable of understanding the transactions ... [he knew prospectuses] did not have rate of return [to prior investors] ... projections ... what assets they might find ... reserves in other programs" (Transcript, pp. 1152-3). That also describes the underwriter Hutton. Hutton knew that knowledge of reserves was essential to any evaluation of these investments (Pet. pp. 9, 13, 30). As an underwriter-broker, it knew "due diligence" projections were substantially

lower than, and conflicted with, issuers' reports for the same reserves. Nevertheless, Hutton circularized issuers' reports rather than its own "due diligence" projections. Hutton encouraged investors to review issuers' reserve reports. (Pet., p. 13).

In short, if Petitioner knew or should have known at the time of his investment in 1981 that he was about to be defrauded, then clearly Hutton knew at the same time that it was defrauding thousands of investors.

Indeed, the question posed by Petitioner is whether proof of reliance is required when an underwriter-broker withholds <u>known</u> profitability projections which established without question these investments were unsuitable for any investor's purpose. (Pet., p. 23). Hutton's knowledge of serious discrepancies between the information investors received and Hutton's own data,

which undermined the very purpose for which these investments were sold, is documented throughout the Petition. (Pet., pp. 8, 9, 11, 13, 18-22, 33, 34, 45).

Therefore, knowledge of falsity with intent that investors rely on issuers' reports is sufficient to establish scienter. Shores, 647 F2d at p. 468.

To any extent necessary to correct errors of law by a lower court, or indeed to provide adequate relief to litigants, this Court has reviewed evidentiary records to supplement and extend findings of the courts below. United States v. General Motors, 384 U.S. 127, 141 (1965), Bose Corporation v. Consumers Union of the U.S., Inc., 466 U.S. 485, 500, 501 (1984).

Finally, the last element required to establish a claim under Rule 10b-5(a) and (c) is materiality of the omissions or whether Hutton committed a fraud on the market. These

are amply discussed in the Petition, expressly and by inference from the record and law applicable to cases of this kind.

Where Hutton admits reserve data is important in making an investment decision <u>and</u> such data is essential for state of the art due diligence and comparisons with other investments, it is erroneous as a matter of law for the Trial Court to conclude that discovered <u>and</u> discoverable reserve data are not material to an investor's decision.

Petitioner is not asking this Court to change the lower courts' findings of fact. Petitioner asks only that the inferences of fact drawn by the Trial Court and its application of the law to those facts and inferences be carefully examined because they are not in accord with the law announced by this Court and other Courts of Appeals.

Therefore, contrary to Respondent's first

assertion, all of the elements necessary to establish a claim under Rule 10b-5(a) and (c) are before this Court, i.e., Hutton's knowledge and intent, Hutton's duty to disclose, materiality of omitted projections and detrimental reliance.

RELIEF

WHEREFORE, Petitioner prays this Honorable Court grant certiorari and reverse the Trial Court's finding that Petitioner failed to prove claims arising under Rule 10b-5(a) and (c), and remand this case to the Trial Court for a determination of damages under the Exchange Act of 1934.

Dated: March 11, 1988

Respectfully Submitted,

By George Platsis

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